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Notes

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NOTES

Antitrust Law—Horizontal Division of Territories and Customer Restrictions

In a recent antitrust case, *United States v. Topco Associates, Inc.*,[1] the United States Supreme Court has taken the opportunity to clarify the legal status of horizontal trade restraints under the Sherman Anti-Trust Act[2]—to wit, they are illegal.

Two issues were before the Court in *Topco*: first, whether the formation of an association by small- and medium-sized grocery chains for the purpose of allocating exclusive sales territories among themselves in order to market privately branded products procured by the association violates section one of the Sherman Act; and secondly, whether the requirement established by Topco's bylaws that all member firms receive special permission from the association before wholesaling association products violates section one of the Sherman Act. More succinctly, the qustion was whether the rule of reason[3] or a *per se* rule[4] should be applied to horizontal territorial and customer restraints. While a pure case of horizontal trade restraints uncomplicated by intentional price fixing arrangements had not been presented previously, the court's holding—that a *per se* rule is applicable—had been presaged repeatedly through dictum and implication.[5]

In the 1940's Topco Associates, Inc., was formed by a group of small grocery chains. Some larger chains were already marketing lines of privately branded products and had thereby gained a competitive advantage. Privately branded products allow the owning chain to sell a high-quality product at a lower price and still realize as much or more profit as would be realized from the sale of a comparable nationally advertised brand. The privately branded products also confer upon the selling chain a certain amount of good will and permit it to enjoy the market power[6] associated with complete dominion over a branded prod-

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[1]92 S. Ct. 1126 (1972).

[2]51 U.S.C. §§ 1-7 (1970). The pertinent provisions of the Act are set out in the text accompanying note 13 *infra*.

[3]*See, e.g.*, Standard Oil Co. v. United States, 221 U.S. 1, 60 (1911).

[4]*See, e.g.*, Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958).

[5]*See, e.g.*, United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379 (1967); White Motor Co. v. United States, 372 U.S. 253, 263 (1963). These cases were not precisely on point. *Schwinn* and *White* involved vertically imposed restraints. Still, in these as well as other cases, the Court went to great lengths to make clear its position concerning horizontal trade restraints. For example, in *White*, the Court stated that "horizontal territorial limitations . . . are naked restraints of trade with no purpose except stifling of competition." *Id.*

[6]This type of market power is generally referred to as monopolistic competition. *See, e.g.*, E. CHAMBERLAIN, THE THEORY OF MONOPOLISTIC COMPETITION (7th ed. 1956).

uct. This arrangement seems to be beneficial to everyone—the smaller producer has an expanded market, the selling chain enjoys increased profits, and the consumer pays lower prices. The only interests injured by this marketing scheme are those of the smaller retailers who do not have the resources to market privately branded products. The formation of Topco was the answer of one group of smaller chains to the competitive challenge of the larger chains.[7]

Topco is an association of approximately twenty-five small and medium-sized retail food chains operating in well over half the states. Except for their association with Topco for purchasing purposes, the food chains are completely independent of each other. None of the member firms operates under the Topco name, and there is no pooling of earnings, management, or advertising resources.[8] Topco merely owns the brand names for a rather large line of foods and nonfood items which it makes available to its member retailers.[9]

Most of Topco's member firms are in a strong competitive position in their respective areas. The average market share of Topco's members amounts to approximately 6%, ranging from 1.5% in some territories to 16% in others.[10] The members' combined retail sales in 1967 came to 2.3 billion dollars. This amount was exceeded by only three of the large national grocery chains.[11] The association now contracts with suppliers to make available to its members more than one thousand separate products.[12] All of this indicates that both collectively and separately the association and its members are a potent economic force.

Section one of the Sherman Act begins with the language: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . ."[13] In *Standard Oil Co. v. United States,* the Court stated that section one contemplated some test for examining trade restraints and that "the standard of reason which had been applied at the common law . . . was intended to be the measure used. . . ."[14] Thus the rule of reason was developed by the courts because of their practical need for a working standard in default

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[7]92 S. Ct. at 1128-32.
[8]*Id.* at 1129.
[9]*Id.* at 1128-32.
[10]*Id.* at 1130.
[11]*Id.*
[12]*Id.* at 1129.
[13]15 U.S.C. § 1 (1970).
[14]221 U.S. 1, 60 (1911).

of a legislative test.[15]

There are many difficulties involved in making an investigation under the rule of reason. It requires an extended analysis by the courts of highly technical areas of the general economy and of the particular markets concerned.[16] This consumes considerable court time and requires a fairly high degree of technical expertise. For example, the district court spent nearly three months in deciding *Topco* under the rule of reason. While the rule of reason has the advantage of flexibility, this very flexibility also prevents business enterprises from making reliable judgments about the legality of contemplated marketing activities.

The need for certainty in the law and the desirability of avoiding the many difficulties and complexities inherently involved in the application of the rule of reason have given rise to the development of a set of *per se* rules that are applied in determining antitrust liability in given situations.[17] In *Northern Pacific Railway v. United States,* Justice Black, a proponent of the *per se* rules, explained their utility and operation as follows: "[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are *conclusively presumed* to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."[18] In short, a practice held to be illegal *per se* under the Sherman Act is conclusively presumed to be unreasonable.[19] Since the rule is basically a tool of convenience the courts have been careful to limit its application to agreements that are essentially anticompetitive. The agreements to which *per se* rules have been most generally applied are tying arrangements,[20] division of mar-

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[15]*See generally* Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* 74 YALE L.J. 775 (1965).

[16]In Board of Trade v. United States, 246 U.S. 231, 238 (1918), the Court tersely stated the scope of an investigation under the rule of reason. There the Court said that in determining the reasonableness of a particular restraint, the courts should look to "the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained are all relevant facts."

[17]Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958). *See generally* Van Cise, *The Future of Per Se in Antitrust Law,* 50 VA. L. REV. 1165 (1964).

[18]356 U.S. 1, 5 (1958) (emphasis added).

[19]United States v. McKesson & Robbins, Inc., 351 U.S. 305, 309-10 (1956).

[20]A tying arrangement is the refusal of a firm to sell one product over which it has some control—for example, a patented product—without an unrelated product, "tied," to it. For cases involving discussion of this practice, *see* United States v. Loew's, Inc., 371 U.S. 38 (1962); Northern Pac. Ry. v. United States, 356 U.S. 1 (1958); International Salt Co. v. United States, 332 U.S.

kets,[21] group boycotts,[22] and price fixing.[23]

The District Court for the Northern District of Illinois decided *Topco* under the rule of reason. The court made extensive findings of fact concerning markets, market shares, history, and purpose and concluded that "[t]he Topco licensing provisions are not inherently unreasonable and have no substantial adverse effect on competition in the relevant market."[24] It determined that any reduction in competition among the member firms and even the complete elimination of competition in Topco brands were outweighed by the increased competition that the member firms are enabled to bring to bear on the large national and regional grocery chains.[25] The court seemed persuaded largely by testimony from Topco officials to the effect that the association would be ruined if not allowed to continue its restrictive practices.[26]

On appeal,[27] the Supreme Court held that Topco's practice of providing licenses to member firms for the exclusive right to sell Topco products in their designated territories is a horizontal territorial restraint,[28] and, *per se*, a violation of the Sherman Act. Similarly, the restrictions placed upon the wholesaling of association products by members was held to be illegal. The Court rejected the implication in the district court's opinion that "good intentions" can take an agreement out of the *per se* rule[29] and concluded that no private group of individuals has the power to foreclose competition in one sector of the economy in order to promote competition in another sector.[30]

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392 (1947).

[21]Division of markets is the division of territories or the allocation of customers by competing firms. For cases involving discussion of this practice, *see* Citizen Publishing Co. v. United States, 394 U.S. 131 (1969); United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967); United State v. White Motor Co., 372 U.S. 253 (1963); Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951); United States v. Addyston Pipe & Steel Co., 175 U.S. 211 (1899).

[22]Group boycotts are agreements among a group of firms not to deal with some firm or group of firms. For cases involving discussion of this practice, *see* United States v. General Motors Corp., 384 U.S. 127 (1966); Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690 (1962).

[23]Price fixing is an agreement among competitors to set prices at a given level. For cases involving discussion of this practice, *see* Simpson v. Union Oil Co., 377 U.S. 13 (1964); United States v. Masonite Corp., 316 U.S. 265 (1942); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

[24]United States v. Topco Associates, Inc., 319 F. Supp. 1031, 1038 (N.D. Ill. 1970).

[25]*Id.* at 1043.

[26]*Id.* at 1042.

[27]The appeal was made directly to the United States Supreme Court persuant to § 2 of the Expediting Act of 1913, 15 U.S.C. § 29 (1970). 92 S. Ct. at 1128.

[28]92 S. Ct. at 1135.

[29]*Id.*

[30]Mr. Justice Blackman wrote in a concurring opinion that while the application of a *per se*

In his dissenting opinion, Chief Justice Burger pointed out that no pure case involving a horizontal territorial restraint had ever been presented.[31] For this reason, and because much of the language cited by the majority concerning horizontal territorial restraints was only dictum, he stated that the Court need not and should not apply a *per se* rule.[32] The Chief Justice did not deal directly with the customer restrictions aspect of the case.

The dissenting opinion relied on *White Motor Co. v. United States*[33] and *United States v. Arnold, Schwinn* & Co.[34] but was somewhat misleading in its treatment of these cases. Both *White* and *Schwinn* involved restrictions of territories and customers imposed vertically by manufacturers on distributors and dealers. In *White,* the district court had applied a *per se* rule by way of summary judgment in favor of the Government. The Supreme Court reversed, but the reversal was probably motivated more by a desire on the part of the Supreme Court to have the issue decided after full disclosure of facts at trial than by disagreement with the district court on the applicability of the *per se* rule. This interpretation of *White* is reinforced by the Court's disposition of *Schwinn,* a case involving facts substantially identical to those in *White.* Even though the defendant, Schwinn, did not appeal the district court's holding that the territorial restraints there were *per se* illegal and despite the Government's failure, perhaps prompted by *White,* to argue for a *per se* rule as to the customer restrictions, the Court went ahead to say that "[u]nder the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. Such restraints are so obviously destructive of competition that their mere existence is enough."[35] As to goods sold, the Supreme Court of the United States had this to say about *both* territorial and customer restrictions in *Schwinn*:[36]

> Once the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict

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rule to the kind of cooperative buying arrangement presented by *Topco* gives an anomolous result, the rule is too firmly established and should now be changed only by Congress. *Id.* at 1136.

[31] *Id.* at 1137.

[32] *Id.*

[33] 372 U.S. 253 (1963).

[34] 388 U.S. 365 (1967).

[35] *Id.* at 379.

[36] 388 U.S. 365 (1967).

> territory or persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee is a *per se* violation of § 1 of the Sherman Act.[37]

The Topco arrangement has the appearance of one brought about vertically because the restraints are technically imposed by the association upon the member retailers. In effect, however, these restraints are effected horizontally[38] by the member firms who created the association.[39] In *United States v. Sealy, Inc.*,[40] the Court was faced with an arrangement almost identical to that in *Topco* (*Sealy* also involved price fixing). Sealy, Inc., owned the trade marks for bedding products. It licensed manufacturers in different sections of the country to produce and market mattresses under the Sealy brand. The licensees were given exclusive territories; no one could be granted a license to manufacture and sell Sealy mattresses in a licensee's territory, and licensees were not permitted to market Sealy branded mattresses outside their designated territories. The Sealy licensees owned substantially all of Sealy's stock and completely controlled its operations.[41] There, the Court stated, "If we look at substance rather than form, there is little room for debate. These must be classified as horizontal restraints."[42]

In view of the language in *Schwinn* concerning a vertical restraint on territories and customers and in view of the characterization in *Sealy* of Topco-type arrangements as horizontal restraints, it should come as no surprise that the Court would hold the restraints in *Topco* to be illegal *per se*. Horizontal restraints are considered highly detrimental to competition because they are imposed by agreement between firms at the same level of trade—firms that should be directly competing with each other. It is for this reason that the courts have traditionally been more suspicious of horizontal restraints than of the vertical ones declared to be illegal in *Schwinn*. While the *Topco* result might have been predicted, the fact remains that the case illustrates the inflexibility of application of a *per se* rule. The majority in *Topco* seems to agree with

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[37] *Id.* at 382.

[38] *See* Aycock, *Antitrust and Unfair Trade Practice Law in North Carolina—Federal Law Compared*, 50 N.C.L. REV. 199, 221-23 (1972).

[39] Topco is completely controlled by its members who own all of the outstanding shares of stock. The board of directors is drawn exclusively from the executive officers of the member firms, and the executive officers of Topco are drawn exclusively from the Topco board of directors. There are restrictions upon the alienation of Topco stock by the members. 92 S. Ct. at 1129.

[40] 388 U.S. 350 (1967).

[41] *Id.* at 351-54.

[42] *Id.* at 352.

the district court that the Topco arrangement may not be evil and may even be a positive good. Nevertheless, the agreement is illegal under the *per se* rule.

In *White*, the Court suggested that in cases involving failing businesses and newcomers, exceptions might be made to allow decision under the rule of reason rather than under a *per se* rule.[43] While *Topco* involved neither situation, perhaps another exception could be devised to cover cases like *Topco* involving a technically forbidden arrangement that may in fact be beneficial to the public from a competitive standpoint. Professor Oppenheim has made a proposal along these lines. He has suggested that a *prima facie* approach be used in the application of the *per se* rule.[44] Under this approach, the Government need only show the existence of the forbidden arrangement or practice to establish a *prima facie* case. Then the burden would shift to the defendant to show the reasonableness of, or justification for, the practice. The difficulty with this proposal is that the courts would still be required to "ramble through the wilds of economic theory,"[45] with the result that the purpose of the *per se* rule would be defeated.

Topco was decided correctly because the need for *per se* rules is obvious and because the very nature of a *per se* rule requires that it be applied blindly. To be sure, the rule could be extremely oppressive if it were haphazardly formulated; but the courts have carefully considered horizontal territorial restraints and customer restrictions in many different business settings and time after time have found them to be anticompetitive and without any redeeming value. The idea of competitors getting together, dividing up markets, and agreeing not to compete is repugnant to the spirit of the Sherman Act. *Topco* probably presents these restraints in the most appealing setting possible, but it is nevertheless apparent that the arrangement eliminates competition insofar as Topco brands are concerned and reduces the ability of nonmember small retailers to compete. While the Topco arrangement does allow the member firms to compete better with the larger chains, it is far from clear that this benefit to the public outweighs the damage caused by reduced competition.

It is not clear that the Topco-type arrangement has been badly damaged by the decision. The association still has the right to sell only

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[43]372 U.S. at 263-64.

[44]Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139, 1158-61 (1952).

[45]92 S. Ct. at 1134 N.10.

to member chains; and, because of geographical separation, the members are not natural competitors. But even if some direct competition should arise as a result of the expansion of some of the members, there remains a competitive advantage, albeit shared, over the nonmember chains operating in the area of overlap. Also, since the reason for the formation of the association was to provide the member *retail* chains with private labels so that they might better compete with the larger chains, it would seem that wholesaling should amount to a relatively insignificant part of the members' sales.

The significance of *Topco* is that it reaffirms the Court's commitment to *per se* rules of the illegality of certain agreements and practices under the Sherman Act and establishes to a certainty that horizontal territorial restraints and customer restrictions are *per se* illegal *even when not accompanied by price fixing.*[46] It appears that the Court has followed a more or less straight course in arriving at the *Topco* decision. When faced with this pure case of horizontal territorial restraints and customer restrictions, the Court did just what it had indicated it would do. Now, with *Topco* placed beside *Schwinn,* it seems clear that division of territories among competitors or restrictions upon the customers to whom they may sell are *per se* violations of the Sherman Act whether the arrangement is brought about horizontally or vertically.

D. STEVE ROBBINS

Constitutional Law: Conventional Reluctance or Doctrinal Departure? The Political Question Doctrine.

Shortly before the 1972 Democratic National Convention, the Supreme Court was asked to consider a suit, *O'Brien v. Brown,*[1] filed by California delegates who had been excluded from the Convention by a ruling of the Democratic Credentials Committee.[2] The Court, uncomfortably confined by lack of time, issued a brief opinion which both delayed action on the petition for certiorari and stayed the Court of

[46]*See generally Case Comment, Horizontal Territorial Restraints and the Per Se Rule, 28 Wash. & Lee L. Rev. 457 (1971).*

[1]92 S. Ct. 2718 (1972) (per curiam). The petition for certiorari was filed on July 6, 1972 and the full convention began July 10th.

[2]The 1972 Credentials Committee had issued its decision on June 29, 1972. Brown v. O'Brien, No. 72-1628, at 4 (D.C. Cir. July 5, 1972).

Appeals' intervening judicial hand. Thus the Convention was left to its own devices.

In its opinion the Court chose to stress "grave doubts" about the judiciary's power to review such matters, saying that "[h]ighly important questions are presented concerning justiciability, . . . state action, and . . . the reach of the Due Process clause."[3] In light of the vigorous expansion of the justiciability[4] and state action[5] doctrines in the past decade, particularly in voting rights cases,[6] one might have assumed those considerations would pose no barrier. Until the Court subsequently develops and clarifies its doubts, however, the applicability of the doctrines to national political party affairs, and perhaps to a range of other cases, is shrouded in uncertainty.[7]

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[3]92 S. Ct. at 2719.

[4]*See* Scharpf, *Judicial Review and the Political Question: A Functional Analysis*, 75 YALE L.J. 517 (1966); Tollett, *Political Questions and the Law*, 42 U. DET. L.J. 439 (1965); Note, *Constitutional Safeguards in the Selection of Delegates to Presidential Nominating Conventions*, 78 YALE L.J. 1228 (1969). For earlier but still valuable opinion *see generally* Field, *The Doctrine of Political Questions in the Federal Courts*, 8 MINN. L. REV. 485 (1924); Finkelstein, *Judicial Self-Limitation*, 37 HARV. L. REV. 338 (1924).

[5]*See* Black, *The Supreme Court, 1966 Term, Foreword: "State Action," Equal Protection, and California's Proposition 14*, 81 HARV. L. REV. 69 (1967); Chambers & Rotunda, *Reform of Presidential Nominating Conventions*, 56 VA. L. REV. 179, 194 (1970); Comment, *Constitutional Reform of State Delegate Selection to National Political Party Conventions*, 64 NW. J.L. REV. 915, 918 (1970); Note, *The Presidential Nomination: Equal Protection at the Grass Roots*, 42 S. CAL. L. REV. 169 (1968).

[6]Avery v. Midland County, 390 U.S. 474 (1968); Reynolds v. Sims, 377 U.S. 533 (1964); Wesberry v. Sanders, 376 U.S. 1 (1964); Gray v. Sanders, 372 U.S. 368 (1963); Baker v. Carr, 369 U.S. 186 (1962); *see* Bode v. National Democratic Party, 452 F.2d 1302 (D.C. Cir. 1971), *cert. denied*, 92 S. Ct. 684 (1972); Georgia v. National Democratic Party, 447 F.2d 1271 (D.C. Cir.) (per curiam), *cert. denied*, 404 U.S. 858 (1971); *cf.* Moore v. Ogilvie, 394 U.S. 814 (1969); Williams v. Rhodes, 393 U.S. 23 (1968).

[7]This note will not deal with state action and the reach of the due process clause, though some of the cases examined bear on those issues. Regarding state action we may observe briefly that though no state or national laws impinged directly on the convention itself, all delegates were selected subject to state laws. Further, in view of the white primary cases, the delegate selection procedures, if not the entire convention, should be subject to scrutiny at least where allegations of constitutional impropriety relate directly to the selection of a presidential candidate. Similar arguments have been heard with favor by the courts in cases cited note 73 *infra*.

The alleged due process violation in *O'Brien*, moreover, was a fundamental one—that rules of delegate selection were altered after the selection process was completed. The authority of the various Democratic bodies who first approved California's procedures and then disapproved them may be difficult to ascertain, but the product of their disagreement was a violation of the expectations of all who cast ballots in California. A holding that the due process clause could not reach this *ex post facto* reversal of voting procedures, if justiciability and state action were found, would be unjustified.

THE DECISION IN O'BRIEN V. BROWN

After a plurality victory in the California presidential primary,[8] Senator George McGovern seemed to have captured all 271 delegates to the National Convention.[9] Subsequently, however, challengers sought a partial ouster of his delegates, insisting that California's "winner-take-all" primary procedure violated the mandate for a "full, meaningful and timely opportunity to participate" in delegate selection[10] which had been adopted by the 1968 Democratic Convention.[11] When the Credentials

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[8]N.Y. Times, June 7, 1972, at 1, col. 8.

[9]*See* CAL. ELECTIONS CODE §§ 6300-98 (West Supp. 1972), especially § 6386. The California State Democratic Party had been assured by National Party Chairman Lawrence O'Brien in a February 1, 1972, letter that the state laws were in "full compliance" with Democratic guidelines. B. Marshall, Hearing Officer, In the Matter of the Challenges to the California Delegation to the 1972 Democratic National Convention: Findings, June 27, 1972, at 3 [hereinafter cited as *Hearing*].

[10]It is understood that a State Democratic Party in selecting and certifying delegations to the National Convention thereby undertakes to assure that such delegates have been selected through a process in which all Democratic voters have had a full and timely opportunity to participate.

In determining whether a state party has complied with this mandate, the convention shall require that:

(1) The unit rule not be used in any stage of the delegate selection process; and

(2) All feasible efforts have been made to assure that delegates are selected through party primary, convention, or committee procedures open to public participation within the calendar year of the National Convention.

Transcript of Proceedings: The 35th Quadrennial Convention of the Democratic National Convention, Aug. 26-29, 1968, at 269 [transcript errors corrected], *quoted in* Segal, *Delegate Selection Standards: The Democratic Party's Experience,* 38 GEO. WASH. L. REV. 873, 879 (1970).

[11]Except for loyalty and anti-discrimination requirements, the Democrats operated until 1968 largely without imposing rules of delegate selection on state organizations. Segal, *supra* note 10, at 876-77. At the 1968 Convention, however, the Party adopted its mandate and authorized a commission to "aid State Democratic Parties in fully meeting the responsibilities and assurances thus required", *Id.* at 878; this gave the national apparatus greatly expanded powers of scrutiny over state selection processes. *See generally* Schmidt & Whalen, *Credentials Contests at the 1968—and 1972—Democratic National Conventions,* 82 HARV. L. REV. 1438 (1969). The commission, under the chairmanship of Senator George McGovern, decided that guidelines were necessary to enforce the mandate. Guidelines were therefore developed and promulgated to state parties, and it was on the basis of such guidelines that the California challengers first disputed the primary results. When a hearing officer appointed by the Credentials Committee found that the winner-take-all arrangement did not violate the guidelines, *Hearing* 7-8, the challengers switched to the argument that the primary had violated the 1968 mandate itself. Brown v. O'Brien, No. 72-1628, at 8-9 (D.C. Cir. July 5, 1972).

The California delegates argued that the 1968 mandate did not require abolition of winner-take-all primaries; indeed, they argued that the 'legislative history' of the mandate led to the contrary conclusion. *Id.* at 9. The delegates said further that the acceptance of the guidelines by all the candidates, and by national and state party officials, as well as explicit national party approval of California's arrangement, *Hearing* 3, prevented the Credentials Committee from altering or re-interpreting the rules after the election.

Committee sustained this challenge and unseated 151 of McGovern's delegates,[12] the ousted Californians sought judicial relief, alleging that the Credentials Committee and the national party had violated their fourteenth amendment rights to due process[13] and equal protection of the laws.[14] (They were joined by ousted delegates from Illinois, who had sued separately but whose case was decided jointly by the courts.[15])

The complaint was dismissed by the district court.[16] The court of appeals then affirmed the dismissal of the Illinois complaint but reversed the dismissal of the California complaint, remanding to the district court with instructions to declare the Credentials Committee ruling null and void and to enjoin the Party from excluding the McGovern delegates.[17] Justiciability was not even addressed by the appellate court. Nor did the court of appeals' opinion appear to have difficulty in finding requisite state action[18] on the authority of *Terry v. Adams*[19] and *Georgia v. Natinal Democratic Party*.[20] Instead, the court examined the force of 1968 mandate and the McGovern guidelines[21] and held that the Credentials Committee had violated due process of law by defying these guidelines.[22]

The California challengers and the Democratic Party immediately

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[12]The intraparty authority as to the McGovern Guidelines is somewhat unclear. The National Democratic Committee had adopted the guidelines at a February, 1971 meeting. Brown v. O'Brien, No. 72-1628, at 6 (D.C. Cir. July 5, 1972). It was they who had assured the state party that the winner-take-all primary was in full compliance. Yet Eli Segal, who had served as counsel for the McGovern Commission, wrote in 1970 that the National Committee had no right to approve the guidelines after their development. "In essence," he wrote, "the National Convention should be viewed as a self-contained legal system. . . . [t]he legality of the [mandate] and the Commission's efforts to implement it are subject to judicial review by the 1972 Credentials Committee and the Convention itself." Segal, *supra* note 10, at 883 n.58.

[13]Brown v. O'Brien, No. 72-1628, at 5-6 (D.C. Cir. July 5, 1972).

[14]Plaintiffs asserted that delegates from twelve states were selected pursuant to some variant of the winner-take-all principle. *Id.* at 12 n.4.

[15]Fifty-nine Illinois delegates were excluded when challengers alleged violation of several guidelines involving open and fair processes for delegate selection. The challengers' allegations were supported by a hearing officer and affirmed by the full Committee. In their suit, the ousted Illinois delegates urged that each of the guidelines as applied to them was unconstitutional, either abridging their rights as delegates under Illinois law or, insofar as they imposed quotas, violating their rights under the equal protection clause. *Id.* at 12-22. Though the case was considered jointly with the California challenge, this note will not discuss the issues it raised.

[16]92 S. Ct. at 2719.

[17]Brown v. O'Brien, No. 72-1628 (D.C. Cir. July 5, 1972).

[18]*Id.* at 6.

[19]345 U.S. 461 (1953).

[20]477 F.2d 1271 (D.C. Cir.) (per curiam), *cert. denied*, 404 U.S. 858 (1971).

[21]The guidelines are discussed in notes 11-12 *supra*.

[22]No. 72-1628, at 10-12.

petitioned the Supreme Court for a writ of certiorari, asking for an expedited hearing and a temporary stay of the court of appeals' order. The Court convened but did not hear the parties or ask for briefs. Instead they granted a stay of the appellate decision until a subsequent date. The effect was to "unseat" the elected McGovern delegates. The Court's *per curiam* decision expressed reluctance to permit judicial interference in the "internal determinations of a national political party."[23] The Court asserted that such action would be unprecedented, distinguishing *Terry v. Adams* and *Smith v. Allwright*[24] as cases "in which claims are made that injury arises from invidious discrimination based on race in a primary contest within a single State."[25] Noting that the Convention itself was a "forum" for possible redress, the Court gave the Democrats responsibility for untangling the combatants and settling the fight.[26]

Justice Marshall, joined by Justice Douglas, registered a strong dissent.[27] He quarreled with the intimation that the issue was nonjusticiable as a political question, recalling that "[h]alf a century ago, Justice Holmes . . . made it clear that a question is not 'political' in the jurisdictional sense, merely because it involves the operations of a political party . . ."[28] Marshall argued that the separation-of-powers considerations which underlay the doctrine were inapplicable to political parties; that judicially manageable standards, mandated by *Baker v. Carr*,[29] were clearly available to judge the merits of the claim; and that the involvement of the state at all levels of the primary and general election for President provided the necessary state action.[30]

THE SUPREME COURT AND THE POLITICAL QUESTION DOCTRINE

According to *Powell v. McCormack*,[31] justiciability resolves itself into two considerations: "whether the claim presented and the relief sought are of the type which admit of judicial resolution [and] whether

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[23]92 S. Ct. at 2720.

[24]321 U.S. 649 (1944).

[25]92 S. Ct. at 2720 n.1.

[26]The full Convention subsequently reversed the decision of the Credentials Committee for reasons not altogether judicial or deliberate. N.Y. Times, July 11, 1972, at 1, col. 8.

[27]92 S. Ct. at 2721.

[28]*Id.* at 2723. Justice Marshall was referring to Justice Holmes' remarks in Nixon v. Herndon, 273 U.S. 536, 540 (1927).

[29]369 U.S. 186, 217 (1962).

[30]92 S. Ct. at 2724.

[31]395 U.S. 486 (1969).

the structure of the Federal Government renders the issue presented a 'political question'. . . ."[32] It is not surprising that the political question doctrine has been the subject of much disagreement, for it is closely tied to fundamental constitutional debates on the justification and purpose of judicial review in a democratic society.[33] The Supreme Court has favored a separation-of-powers interpretation of the doctrine in recent cases.[34] In fact, it has departed from that interpretation only in the direction of greater judicial intervention.

A leading case interpreting the political question doctrine is *Baker v. Carr*.[35] The appellants in *Baker* sued complaining that the Tennessee legislature, contrary to its own constitution,[36] had not reapportioned itself at regular intervals to reflect population changes.[37] Alleging that they were without other means of relief, appellants claimed they had been denied equal protection of the laws under the fourteenth amendment.[38] A three-judge district court invoked procedural grounds, including nonjusticiability, to forego a decision on the merits.

The Supreme Court remanded the case to the district court, partly because of its misinterpretation of justiciability. It was not a case's *political flavor* which brought it within the doctrine, but whether the

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[32]*Id.* at 516-17.

[33]Those who follow Chief Justice Marshall's reasoning in *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803), that judicial review is a duty imposed by the Constitution tend to see justiciability as a question of the separation of powers. Thus Professor Wechsler insisted in his grand defense of this "classical" tradition," [A]ll the doctrine can defensibly imply is that the courts are called upon to judge whether the Constitution has committed to another agency of government the autonomous determination of the issue raised, a finding that itself requires an interpretation." Wechsler, *Toward Neutral Principles of Constitutional Law*, 73 HARV. L. REV. 1, 7-8 (1959).

This view has been strongly attacked for the rigidity of its insistence on the necessity of judicial intervention. Learned Hand argued that courts had the positive duty to intervene only where there was a particular reason to do so, even when another agency had exceeded its constitutional authority. L. HAND, THE BILL OF RIGHTS 1-30 (1958). In this analysis, the political question doctrine became proof of the court's discretion to intervene or remain apart. Alexander Bickel's influential theory of the role of the judiciary similarly assigned justiciability a place among devices to postpone, on procedural grounds, certain difficult questions which the Court judged might strain its social legitimacy to decide. Bickel, *The Supreme Court 1960 Term, Foreword: The Passive Virtues*, 75 HARV. L. REV. 40 (1961). For a more complete discussion of the underpinnings of the political question doctrine, *see* Scharpf, *supra* note 4.

[34]*See generally* note 6 *supra*.

[35]369 U.S. 186 (1962).

[36]*Id.* at 188-89.

[37]*Id.* at 191.

[38]The logic was that insofar as a representative from an urban area might represent thousands more voters than one from a rural area, the voting power of the urban dweller was debased relative to that of the rural voter.

configuration of circumstances made it a threat to separation of powers.[39] In an extensive review of cases, the majority carefully demonstrated that no litmus paper test sufficed to explain justiciability decisions. "[S]weeping statements to the effect that all questions touching foreign relations are political questions"[40] as with generalizations about other ostensibly proscribed judicial areas, were simply inaccurate.

> Prominent on the surface of any case held to involve a political question is found a textually demonstrable constitutional commitment of the issue to a coordinate political department; or a lack of judicially discoverable and manageable standards for resolving it; or the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion; or the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of government; or an unusual need for unquestioning adherance to a political decision already made; or the potentiality of embarrassment from multifarious pronouncements by various departments on one question.[41]

Despite the highly charged political issue of the apportionment of political power between urban and rural residents in Tennessee, the majority in *Baker* saw nothing to deter the district court from reaching a decision on the merits. The Tennessee legislature was not a coordinate political department at the crucial federal level, and judicial standards were available to decide the issue.[42]

Frankfurter and Harlan strongly dissented from the *Baker* decision.[43] Frankfurter read the plaintiff's claim as a covert use of the Guaranty Clause,[44] which the Court had long held to be nonjusticiable.[45] Further, and more important for purposes of this discussion, he insisted

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[39]369 U.S. at 209-10.

[40]*Id.* at 211.

[41]*Id.* at 217.

[42]This was in fact not a procedural argument but a substantive one. Brennan, Black, Warren and Douglas eventually came to insist that extra-mathematical factors, such as a balance between geographical regions within a state, were impermissible if they led to a debasement of comparative voting strength. Reynolds v. Sims, 377 U.S. 533 (1964); Wesberry v. Sanders, 376 U.S. 1 (1964).

[43]Frankfurter echoed many of the arguments he had advanced in an earlier redistricting case, Colegrove v. Green, 328 U.S. 549 (1946), which had been controlling until *Baker.*

[44]"The United States shall guarantee to every State in this Union a Republican Form of Government . . . ." U.S. CONST. art. IV, § 4.

[45]The original case on the Guaranty Clause was Luther v. Borden, 48 U.S. (7 How.) 1 (1849). While agreeing with Frankfurter that Guaranty cases were nonjusticiable, the *Baker* majority saw the Guaranty Clause as defining the judiciary's relation to Congress, not its relation to the states, 369 U.S. at 210, and rejected Frankfurter's claim that any complaint which could be restated as a Guaranty case was thereby barred from review. *Id.* at 227.

the question was the sort of complex political decision in which the courts had no business engaging.[46]

The majority of the Court, however, was able, consistent with separation of powers, not only to intervene in *Baker v. Carr,* but to sanction a series of reapportionment cases at the state,[47] county,[48] even municipal[49] levels—both in general and in primary elections—in which similar claims of voting debasement were voiced.

Among these cases was *Wesberry v. Sanders*[50] in which the Court affirmed both its strong commitment to protect voting rights and its boldness in the face of difficult political situations. Appellants in *Wesberry* were members of Georgia congressional districts who claimed that malapportionment gave less populous districts far greater proportional influence in Congress. The respondents countered that article I, section 4 of the Constitution gave the states authority over such districting, subject to Congressional legislation.[51] In a decision which some observers interpreted as a move beyond a separation-of-powers theory,[52] Justice Black saw support in *Baker* for the proposition that "nothing in the language of that article gives support to a construction that would immunize state congressional apportionment laws which debase a citizen's right to vote from the power of the courts . . . a power recognized at least since our decision in *Marbury v. Madison.*"[53]

Recently, in a case decided under another provision of the Constitution, the Supreme Court again displayed the same kind of judicial assertiveness in a justiciability dispute. In *Powell v. McCormack,*[54] black congressman Adam Clayton Powell sought to be seated in the

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[46]In *Colegrove* Frankfurter had written: "Nothing is clearer than that this controversy concerns matters that bring courts into immediate and active relations with party contests. . . . It is hostile to a democratic system to involve the judiciary in the politics of the people." 328 U.S. at 553-54.

[47]*E.g.,* Lucas v. Forty-Fourth Gen. Assembly, 377 U.S. 713 (1964); Davis v. Mann, 377 U.S. 678 (1964); WMCA, Inc. v. Lomenzo, 377 U.S. 633 (1964).

[48]*E.g.,* Avery v. Midland County, 390 U.S. 474 (1968); Simon v. Lafayette Parish Police Jury, 226 F. Supp. 301 (W.D. La. 1964); Bianchi v. Griffing, 217 F. Supp. 166 (E.D.N.Y. 1963).

[49]Ellis v. Mayor & City Council, 352 F.2d 123 (4th Cir. 1965).

[50]376 U.S. 1 (1964).

[51]The Times, Places, and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof; but the Congress may at any time by Law make or altar such Regulations, except as to the Places of chusing Senators.

[52]Kauper, *Some Comments on the Reapportionment Cases,* 63 MICH. L. REV. 243, 244 (1964); Tollett, *supra* note 4, at 459.

[53]376 U.S. at 6.

[54]395 U.S. 486 (1969).

House of Representatives after being excluded by a decision of House members angry over Powell's misuse of funds. Powell's opponents claimed that article I, section 5 of the Constitution[55] gave Congress the power to judge its membership and made the issue of seating him nonjusticiable. The Court responded that it alone possessed supreme authority to interpret the Constitution, even those sections that involved "textually demonstrable constitutional commitments" to other branches.[56] The Court also directly confronted the argument that decision of the case had involved a "potentiality of embarrassment from multifarious pronouncements by various departments" or expressed a "lack of the respect due coordinate branches" within *Baker's* definition of justiciability. With ironic modesty, Chief Justice Warren wrote that reaching the merits "would require no more than an interpretation of the Constitution . . . ."[57]

It should be clear from *Baker, Wesberry,* and *Powell* that the Court has not seen the political question doctrine as a warning to tread gingerly when political passions are aroused and partisan voices are raised. The doctrine appears more theoretical than prudential; it is grounded in the Court's interpretation of its proper function as limited by inherent judicial capacity and by constitutional delegation of responsibilities to other branches at the federal level.

THE POLITICAL QUESTION DOCTRINE AND THE POLITICAL PARTIES

Having established the doctrinal framework, we must now examine its specific application to political parties to determine if the courts have found any general grounds to exempt party affairs from review. As the majority in *O'Brien* intimated, *Smith v. Allwright* and *Terry v. Adams* strongly suggest that the Supreme Court has not regarded *all* political party affairs as nonjusticiable where they affect constitutionally protected activity.[58] The *Smith* court insisted that blacks be allowed a vote in the state Democratic Party primary, even though the Party Convention had voted to exclude them.[59] In *Terry,* the Court saw through an

[55]"Each House shall be the Judge of the Elections, Returns and Qualifications of its own Members . . . . Each House may determine the Rules of its Proceedings, punish its Members for disorderly Behaviour, and, with the Concurrence of two thirds, expel a Member."

[56]395 U.S. at 521, *quoting* Baker v. Carr, 369 U.S. 186, 217 (1962).

[57]395 U.S. at 548. "Such a determination falls within the traditional role accorded courts to interpret the law, and does not involve a 'lack of the respect due [a] coordinate [branch] of government'. . . . The alleged conflict that such an adjudication may cause cannot justify the courts' avoiding their constitutional responsibility." *Id.* at 548-49.

[58]92 S. Ct. at 2720 n.1.

[59]321 U.S. at 656-63.

insidious twist on this "white primary" arrangement. Hoping to escape judicial scrutiny, a private "Jaybirds Association" had been formed which held its own primary prior to the officially sanctioned Democratic primary. The Jaybird winners almost without exception ran for Democratic office and were perennially successful. In finding that this ostensibly private political activity was subject to judicial review, the Court proclaimed its unwillingness to be mocked by subterfuge.[60]

The O'Brien reference to *Smith* and *Terry* seems to imply, however, that *only* where race is involved will the Court overcome a traditional reluctance to disturb political parties. This note will examine the four cases the *O'Brien* majority cited for its theory of judicial noninterference, attempting to show that even they refute the Court's inference.

One of those cases, *Lynch v. Torquato*,[61] involved a complaint by residents of a Pennsylvania county that their Democratic County Chairman was chosen under state law by precinct leaders representing precincts of widely varying population. The appellants argued that under *Gray v. Sanders*[62] such a "unit system" denied them equal protection of the laws. Additionally, they argued that the Democratic Chairman's right personally to select a stand-in whenever a candidate in a Democratic primary withdrew also denied them equal protection. The circuit court dismissed the appeal and distinguished between the right to select *general* governmental representatives and the right to select other kinds of representatives. The court, however, reserved judgment on the alleged undemocratic process by which the Chairman appointed a stand-in candidate.[63] In fact, although the court refused to intervene in the election of the party's internal manager, it confessed that it *might enjoin* the selection of a stand-in by the unrepresentative Chairman if the question arose in concrete form.[64]

In *Ray v. Blair*,[65] the Supreme Court refused to grant mandamus to force certification by the Alabama Democratic Executive Chairman of a candidate for presidential elector who refused to sign a loyalty oath to the Democratic Party. Again, the Court's reason for the denial was not that it eschewed all party primary disputes but that such disputes were immaterial *unless* they violated some constitutional or statutory

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[60] 345 U.S. at 469-70.
[61] 343 F.2d 370 (3d Cir. 1965).
[62] 372 U.S. 368 (1963).
[63] 343 F.2d at 372.
[64] *Id.* at 372-73.
[65] 343 U.S. 214 (1952).

provision.[66]

The other two cases on which the *O'Brien* majority relied both involved claims that procedures used in the selection of delegates to state party conventions violated strict one-man, one-vote standards. In *Irish v. Democratic-Farmer-Labor Party,*[67] the court seemed to grasp at a myriad of reasons for deciding against the appellant. It mentioned judicial reluctance to enter intra-party disputes. It declared the issue nonjusticiable, both because of a lack of judicially manageable standards—offering no explanation why the Supreme Court's insistent progression of decisions from *Baker* to *Gray* were inapposite—and "perhaps" because of a lack of respect due coordinate branches of government.[68] Not content to rest on these grounds, however, the court, admitting that the judiciary had properly intervened in party affairs for racial *and constitutional principles,* held that there was nothing of constitutional significance in the alleged malapportionment of the Democratic state convention.[69]

Smith v. State Executive Committee[70] involved a claim that the Democratic Party's method of selection of delegates to the Georgia state convention violated equal protection. The court found that since party officials had invoked their discretion to permit open attendance at the last convention, the rules *as applied* were not actionable. It thus avoided the decision whether it would have intervened had an actual violation occurred. Nevertheless, the court urged the party to find better procedures, quoting *Lynch's* speculation that despite hesitation about meddling in party affairs, a violation of constitutionally protected rights might require it.[71]

These last two cases, which have received serious criticism in more recent court decisions,[72] were essentially rearguard actions to protect state party conventions from the logic of *Baker* and *Gray.*[73] Neverthe-

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[66]*Id.* at 227.

[67]399 F.2d 119 (8th Cir. 1968).

[68]*Id.* at 121.

[69]*Id.* at 120.

[70]288 F. Supp. 371 (N.D. Ga. 1968).

[71]*Id.* at 376.

[72]Georgia v. National Democratic Party, 477 F.2d 1271 (D.C. Cir.) (per curiam), *cert. denied,* 92 S. Ct. 109 (1971); Maxey v. State Democratic Committee, 319 F. Supp. 673 (W.D. Wash. 1970); *see* Bode v. National Democratic Party, 452 F.2d 1302 (D.C. Cir. 1971), *cert. denied,* 92 S. Ct. 684 (1972).

[73]The courts worked to find reasons why equal protection principles, although they applied to presidential party primaries, did not apply to delegate selection which occurred at party conventions. The history of Supreme Court decisions involving voting rights, as we have seen, argues that such loopholes should not be tolerated. *See* cases cited notes 6, 47 *supra.*

less, each was careful to admit that in circumstances other than those they adjudicated, intervention would be permissible, even mandatory.

CONCLUSION

The *O'Brien* majority correctly noted general judicial reluctance to become involved in political party disputes. However, even those cases they cited for this proposition indicate intervention is proper when party practices violate the Constitution. This determination is not surprising; indeed, the theoretical foundations of the political question doctrine seem to forbid any other conclusion. Political parties, however influential in national affairs, are not a coordinate branch of government entitled to deference because of separation of powers. Furthermore, if party voting arrangements are justiciable when they violate one provision of the Constitution (as in *Smith* and *Terry*), it is difficult to conceive why they may be held nonjusticiable when they allegedly contravene another.

Such considerations combine to make the Court's "grave doubts" puzzling. One explanation for the doubts is that the Court plans to abandon the separation-of-powers interpretation for a prudential theory. If the Court's remarks in *O'Brien* portend an imminent about-face of such major proportions, it is understandable that they have preferred to await a more propitious opportunity to expound their change.

A second possible conclusion is that the Court would distinguish between state parties and national parties for purposes of the justiciability doctrine. Yet the considerations which *Baker* cited as determinative of justiciability[74] seem irrelevant to any distinction between state and national parties. More important, at least since *United States v. Classic*,[75] the Court has recognized that an election is a fabric of a single piece; there is no rational point at which the courts should cease their vigilant protection of the right of suffrage.

A better conclusion, one to which the Court several times made allusion, is that the intricate relations between the various Democratic "players"—the McGovern Commission, the National Committee, the Credentials Committee—and the pressure of time prevented the Court

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[74]369 U.S. at 217; *see* note 41 and accompanying text *supra*.

[75]313 U.S. 299, 318 (1941): "Where the state law has made the primary an integral part of the procedure of choice . . . the right of the elector to have his ballot counted at the primary is likewise included in the right protected by Article I, § 2. And this right of participation is protected just as is the right to vote at the election . . . ."

from reaching a rapid decision on the merits.[76] Only an explanation grounded in momentary reticence rather than absolute refusal is consonant with the nature of the doctrine and the history of its application.

Constitutional Law—First Amendment—The Balancing Process for Free Exercise Needs a New Scale

Personal freedoms have been affected substantially by the steadily increasing scope of governmental regulation.[1] In *Wisconsin v. Yoder*,[2] the Supreme Court granted the Amish people an exemption from the compulsory education laws of the state, basing its decision on first amendment free exercise of religion grounds. The potential tension between the free exercise of religion and extensive regulation is exacerbated in *Yoder* by a contemporary emphasis on education, by the interests of minors whose educational and religious futures are directly affected by the Court's ruling, by the question of survival of a devout separatist sect, and by the political reality that numerous exemptions will make a regulatory scheme unworkable.

Three sets of Amish parents in Wisconsin,[3] believing it sinful to expose their children to the worldliness of the county consolidated high school, held their children out of public school in violation of the Wisconsin compulsory education law, which requires attendance to the age of sixteen.[4] They were prosecuted, found guilty, and were fined five dollars each.[5] The convictions were affirmed by the state circuit court,

[76]The Court recently granted certiorari and vacated judgment, remanding to the court of appeals with instructions to dismiss as moot. 41 U.S.L.W. 3182 (U.S. Oct. 10, 1972).

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[1]A good example of this tension is a requirement that all children in a school salute the American flag and pledge allegiance. Such an exercise is forbidden to Jehovah's Witnesses by a literal reading of the Ten Commandments. In Board of Educ. v. Barnette, 319 U.S. 624 (1943), the Supreme Court held this requirement an unconstitutional infringement of free exercise.

[2]92 S. Ct. 1526 (1972).

[3]Respondents in the case were Jonas Yoder, Ardin Yutzy, members of the Old Order Amish Religion, and Wallace Miller, a member of the Conservative Amish Mennonite Church. Their children, Frieda Yoder, aged fifteen, Barbara Miller, aged fifteen and Vernon Yutzy, aged fourteen, were all graduates of the eighth grade of public school. *Id.* at 1529 n. 1.

[4]WIS. STAT. ANN. § 118.15 (1972). The pertinent provisions of the statute are:

> (1) (a) Unless the child has a legal excuse or has graduated from high school, any person having under his control a child who is between the ages of 7 and 16 years shall cause such child to attend school regularly during the full period and hours, religious holidays excepted, that the public or private school in which such child should be enrolled is in session until the end of the school term, quarter or semester of the school year in which he becomes 16 years of age.

[5]92 S. Ct. at 1529-30.

but were reversed by the Wisconsin supreme court.[6] The United States Supreme Court affirmed the Wisconsin high court by holding that the state compulsory education laws violated the free exercise of religion by the Amish parents.[7]

The legal issue addressed by the Court consisted of two parts: (1) whether enforcement of the education law was an infringement upon the parents' practice of the Amish religion, and (2) if so, could Wisconsin prove a state interest of sufficient magnitude to override this first amendment right?[8] In deciding this dual issue, the Court addressed the problems of defining the nature of religious beliefs granted protection[9] and the purpose of compulsory education laws.[10] In essence, the religious rights of the parents were balanced against the interest of the state in uniform enforcement of its law. As to the children, Chief Justice Burger, writing the opinion for the Court, stated:

> [O]ur holding today in no degree depends on the assertion of the religious interest of the child as contrasted with that of the parents. It is the parents who are subject to prosecution here for failing to cause their children to attend school, and it is their right of free exercise, not that of the children, that must determine Wisconsin's power to impose criminal penalties on the parent. . . . The children are not parties to this litigation.[11]

Analysis of the free exercise question must begin with a nineteenth century challenge to territorial polygamy laws in *Reynolds v. United States*.[12] There the Supreme Court established an action-belief dichotomy, stating, "[L]aws are made for the government of actions, and while they cannot interfere with mere religious belief and opinions, they may with practices."[13]

Cantwell v. Connecticut,[14] decided in 1940, brought an end to the strict application of the *Reynolds* standard. The Court granted an ex-

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[6]State v. Yoder, 49 Wis. 2d 430, 182 N.W.2d 539 (1971).

[7]Wisconsin v. Yoder, 92 S. Ct. 1526 (1972).

[8]*Id.* at 1532.

[9]Beliefs which are "philosophical and personal, rather than religious . . . [do] not rise to the demands of the Religion Clause." *Id.* at 5133.

[10]The Court used Jefferson's argument that some education is necessary to prepare for active citizenship and to become self-sufficient members of society. But the Court qualified this purpose by viewing the goal as preparation "for life in the separated agrarian community that is the keystone of the Amish faith." *Id.* at 1536.

[11]*Id.* at 1541.

[12]98 U.S. 145 (1878).

[13]*Id.* at 166.

[14]310 U.S. 296 (1940).

emption from the law for the protection of religiously motivated actions and the former action-belief standard was limited to cases where the regulation safeguarded important interests of the community.[15] *Cantwell* ruled that a statute forbidding a person to solicit for a religious cause before obtaining a certificate from a designated state official was an unconstitutional infringement of free exercise and of free expression. The Court went on to say:

> Thus the [First] Amendment embraces two concepts,—freedom to believe and freedom to act. The first is absolute but, in the nature of things, the second cannot be. Conduct remains subject to regulation for the protection of society. . . . [The state may] safeguard the peace, good order and comfort of the community, without unconstitutionally invading the liberties protected by the Fourteenth Amendment.[16]

The type of interest which may be regulated by the government in the face of free exercise objections is exemplified by *Prince v. Massachusetts*.[17] The Massachusetts statute under attack prohibited the sale of magazines or pamphlets by children under a certain age; it was applied to prevent a nine-year-old girl from distributing Jehovah's Witness material on the streets. The Court rejected the claimed right of the guardian to bring up the child according to her own beliefs, asserting that neither the rights of religion nor the rights of parenthood are beyond limitation:

> Acting to guard the general interest in youth's well being, the state as *parens patriae* may restrict the parent's control by requiring school attendance, regulating or prohibiting the child's labor and in many other ways. Its authority is not nullified merely because the parent grounds his claim to control the child's course of conduct on religion or conscience.[18]

Even though an exemption to Sunday closing laws was denied Or-

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[15]In other cases involving free exercise, such as compelling Jehovah's Witness children to salute the flag and taxing the right to distribute religious material, the Supreme Court granted exemptions, thus emphasizing the move from *Reynolds*. Board of Educ. v. Barnette, 319 U.S. 624 (1943); Murdock v. Pennsylvania, 319 U.S. 105 (1943).

[16]310 U.S. at 303-04. *Cantwell* is a hybrid problem involving claims for free exercise of religion and freedom of speech. The Court used a "clear and present danger" standard to solve the problem of the breach of peace possibility (free expression), *id.* at 311, and ruled the solicitation statute was a previous restraint on the free exercise of religion (free exercise), *id.* at 305.

[17]321 U.S. 158 (1944).

[18]*Id.* at 166.

thodox Jewish merchants in *Braunfeld v. Brown*,[19] the Court set forth more rigid requirements for the state to justify uniform application of the law. The merchants would not operate their stores on Saturday, their Sabbath, and sought an exemption allowing them to remain open part of the day on Sunday in order to recover some of the business lost on Saturday. The majority upheld the law, basing its rationale on the importance of the state objective in providing a day of rest for its citizens.[20] An exemption for the Sabbatarians would have provided an administrative problem of such magnitude as to render the entire statutory scheme unworkable. Thus a new factor was introduced into the balancing formula; the state had to show a justifiable purpose for the uniform regulation and why an exemption to its coverage should not be granted.

The standard that the Court applied in *Yoder* was first explicitly set forth in *Sherbert v. Verner*.[21] There a Seventh Day Adventist was denied unemployment compensation because she refused available employment conditioned on her working a six-day week, including Saturday, her Sabbath. The Supreme Court reversed, establishing the current test for free exercise questions. A state may impose restrictions on actions, even when the conduct accords with one's religious convictions, but only if there is a *compelling state interest* for such regulation.[22] Therefore, if the Supreme Court had found that the South Carolina unemployment compensation law had not infringed Ms. Sherbert's free exercise of her religion, or if it had found that any incidental burden on the free exercise were justified by a compelling state interest, the Court would have been able to sustain her disqualification.[23] The forced choice between following the precepts of her religion and foregoing all compensation or foregoing her religion and accepting work was certainly a burden on free exercise.[24] Moreover, the state failed to show any vital interest in the regulation. For example, the possibility of fraudulent

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[19]366 U.S. 599 (1961).

[20]*See id.* at 608-09.

[21]374 U.S. 398 (1963).

[22]The conduct so regulated must pose some substantial threat to public safety, peace, or order. *Id.* at 403.

The state interest itself must be *compelling*. "It is basic that no showing merely of a rational relationship to some colorable state interest would suffice; in this highly sensitive constitutional area, '[o]nly the gravest abuses, endangering paramount interests, give occasion for permissible limitation.'" *Id.* at 406 (citation omitted).

[23]*Id.* at 403.

[24]Significantly, the South Carolina statute allowed an exemption for workers who refuse to work on Sunday due to religious objections. *Id.* at 406.

claims threatening dilution of the enemployment fund was not compelling. The Court said that the state would have to demonstrate that no alternate forms of regulation would combat abuses without infringing first amendment rights.[25]

The importance of the *Sherbert* test is illustrated by two subsequent cases. In one, the Supreme Court vacated a judgment of contempt for a refusal of jury duty based on free exercise claims and remanded for consideration in light of *Sherbert*.[26] The Minnesota high court then reversed its original ruling, holding that the state had not shown a sufficient interest in obtaining competent jurors to require the overriding of free exercise rights.[27] In another case, the California Supreme Court held that the state could not apply its narcotics laws to prevent the use and possession of peyote by Navajo members of the Native American Church for religious ceremonies.[28] The state sought to demonstrate a compelling interest in preventing the deleterious effects of the drug, but the court observed that no such effects had been shown.[29] To the further state contention that the use of peyote obstructed possible enlightenment the court responded, "We know of no doctrine that the state, in its asserted omniscience, should undertake to deny to defendants the observance of their religion in order to free them from the suppositious [*sic*] 'shackles' of their 'unenlightened' and 'primitive condition.' "[30]

One of the basic tenets of the Amish faith is withdrawal from the contemporary world and an emphasis on simple agrarian lifestyle. Members believe that exposure to the worldly curricula and life of consolidated high schools would be harmful to their children and perhaps detrimental to their own salvation.[31] The existence of Amish communities in many sections of the country and the passage of compulsory education laws thus made it inevitable that the question of free exercise infringement would arise in compelling Amish children to attend school until a certain age. The Amish had litigated this question in state courts many times, but cases previous to *Yoder* were decided on the obsolete

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[25]*Id.* at 407.

[26]*In re* Jenison, 265 Minn. 96, 120 N.W.2d 515, *vacated and remanded mem.*, 375 U.S. 14, *rev'd per curiam*, 267 Minn. 136, 125 N.W.2d 588 (1963).

[27]*In re* Jenison, 267 Minn. 136, 137, 125 N.W.2d 588, 589 (1963).

[28]People v. Woody, 61 Cal. 2d 716, 394 P.2d 813, 40 Cal. Rptr. 69 (1964).

[29]*Id.* at 722, 394 P.2d at 818, 40 Cal. Rptr. at 74.

[30]*Id.* at 723, 394 P.2d at 818, 40 Cal. Rptr. at 74.

[31]*See generally* Casad, *Compulsory High School Attendance and the Old Order Amish: A Commentary on State v. Garber*, 16 KAN. L. REV. 423 (1968).

Reynolds action-belief dichotomy.[32] This was true even in *State v. Garber*,[33] a 1966 case decided three years after *Sherbert*. There the Kansas court stated, "The question of how long a child should attend school is not a religious one."[34]

In light of the legal background, *Yoder* appears as a logical progression from the holdings in *Cantwell* and *Sherbert*. Once the *Sherbert* standard[35] is accepted as applicable here, the Court's holding seems quite reasonable. There are a number of weaknesses in the Court's reasoning, but these objections are readily answerable once the implicit premise of the Court is granted—that ideal education for the Amish means preparation for an Amish life and the minimal contacts with contemporary society that such a life entails.[36] Yet the Court's characterization of education and its purpose seems polar to the emphasis given in *Brown v. Board of Education*[37] and the subsequent public school integration cases. In *Brown* the Court stated:

> [E]ducation is perhaps the most important function of state and local governments. Compulsory school attendance laws and the great expenditures for education both demonstrate our recognition of the importance of education to our democratic society. . . . Today it is a principal instrument in awakening the child to cultural values, in preparing him for later professional training, and in helping him to adjust normally to his environment. In these days, it is doubtful that any child may reasonably be expected to succeed in life if he is denied the opportunity of an education.[38]

The purpose attributed to education will *ipso facto* determine the importance of the state's interst.[39] The materialistic description of the

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[32]*E.g.*, State v. Garber, 197 Kan. 567, 419 P.2d 896, *cert. denied*, 389 U.S. 51 (1966); State v. Hershberger, 103 Ohio App. 188, 144 N.E.2d 693 (1955); Commonwealth v. Beiler, 168 Pa. Super. 462, 79 A.2d 134 (1951). The language in *Beiler* is typical: "Religious liberty includes absolute right to believe but only a limited right to act." 168 Pa. Super. at 468, 79 A.2d at 137.

[33]197 Kan. 567, 419 P.2d 896 (1966), *cert. denied*, 389 U.S. 51 (1967).

[34]*Id.* at 574, 419 P.2d at 902.

[35]*See* text accompanying note 8 *supra*.

[36]"It is one thing to say that compulsory education for a year or two beyond the eighth grade may be necessary when its goal is the preparation of the child for life in modern society as the majority live, *but it is quite another if the goal of education be viewed as the preparation of the child for life in the separated agrarian community* that is the keystone of the Amish faith." 92 S. Ct. at 1536 (emphasis added).

[37]347 U.S. 483 (1954).

[38]*Id.* at 493.

[39]*See* State v. Yoder, 49 Wis. 2d 430, 451, 182 N.W.2d 539, 549 (1971) (Heffernan, J., dissenting): "The purpose of education is not alone to provide a mass of educated and, hence, taxable citizens, but is, in addition, intended to educate the individual for life. The government's

purpose of compulsory education by the Court in *Yoder*[40] in effect establishes the state's interest as an uncompelling one, and even though the state's interest in *Yoder* (compulsory education) is dissimilar to the state's interest in *Brown* (compulsory segregation),[41] the Court's position on education seems to have changed considerably. Significantly, however, the petitioner in *Brown* wanted open opportunities in public schools, while the Amish merely desired to be left out of public schools. This difference between *Brown* and *Yoder* probably accounts for the different emphases given public education and to some extent explains the Court's rather uninspired view of the role of schooling in the latter.

The implicit premise of the Court in *Yoder*, that education for the Amish means preparation for Amish life, is the chief weakness of the decision. The rights of those children who might later want to leave the Amish faith were neither adequately represented nor adequately considered by the Court. In the past the Court has considered the state's interest in the welfare of the child, even when faced with a free exercise claim by the parent. For instance, in *Prince v. Massachusetts*,[42] the Court stated, "Parents may be free to become martyrs themselves. But it does not follow they are free, in identical circumstances, to make martyrs of their children before they have reached the age of full and legal discretion when they can make that choice for themselves."[43] Indeed, in the very nature of government, the state's regulative authority over children is broader than over adults, particularly with regard to public activities and in matters of employment.[44]

The rights of children as persons have only recently been established by the Court, mostly in regard to procedures in juvenile proceedings,[45] but these cases have established the trend toward recognizing that

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concern is not with enforcing a regulatory scheme. [It is] that religion, morality, good government, and happiness are all dependent upon education. This is the compelling government nterest."

[40]*See* 92 S. Ct. at 1536-40.

[41]Notwithstanding the dissimilarity of the state's interests, both White in concurrence (joined by Brennan and Stewart), 92 S. Ct. at 1544, and Heffernan in dissent in the Wisconsin court, 49 Wis. 2d at 449, 182 N.W.2d at 548, used the *Brown* philosophy to emphasize the importance of the state's interest in education.

[42]321 U.S. 158 (1944).

[43]*Id.* at 170; *see* text accompanying notes 17-18 *supra.*

In spite of the sweeping language employed by the Court, the ruling was limited to the facts of the case. 321 U.S. at 171.

[44]*Id.* at 168. The Court's position has not changed since *Prince. See, e.g.*, Ginsberg v. New York, 390 U.S. 629 (1968).

[45]*E.g., In re* Winship, 397 U.S. 358 (1970); *In re* Gault, 387 U.S. 1 (1967); Kent v. United States, 383 U.S. 541 (1966).

"children themselves have constitutionally protectible interests."[46] The consideration of those constitutional interests seems especially applicable in a situation where the life options given the child may be substantially narrowed by granting an exemption from a regulatory statute.

The *Sherbert* requirement of a compelling state interest in order to uphold uniform enforcement in effect gives the free exercise side of the scale an additional weight. This advantage is theoretically justifiable on the basis of the importance of insuring adequate protection to the free exercise of religion. However, this reasoning fails when there are other important interests to be protected that are not included in the balance. In *Yoder*, the most important omission in the balancing process is the child's interest in further education. Indeed, a close examination of the children's rights may well counterbalance the compelling interest requirement.

The opposing interests of the Amish children are the educational growth of those children who will later leave the community (state's interest) versus the rights of those children who will remain (free exercise).[47] The Court should weigh the following considerations. The man or woman who leaves the Amish community with but an eighth grade education is not being afforded the educational guarantees of *Brown*. How much will the loss of one or two years of formal education stunt his capacity for growth?[48] Is this lack of education an important enough factor to allow the state to find a way to protect his growth at the expense of his parents' religious beliefs? On the other side of the scale, the child who is forced to attend public school against the precepts of his chosen faith and lifestyle is not being adequately prepared for his life inside the Amish community and may even be damaged by exposure to the outer world. How much has the additional exposure to the worldliness of high school injured his opportunity for satisfied life within the community? Is this injury a sufficient factor to allow an exemption for all Amish children beyond the eighth grade? In order to protect the rights of some of the children, an order affecting the lives of all the

[46]92 S. Ct. at 1547 (Douglas, J., dissenting in part).

[47]The estimated number of these departing children is important and should be considered in the balancing test. Justice White, in concurring with the result reached, stated that "[t]here is evidence in the record that many children desert the Amish faith when they come of age." 92 S. Ct. at 1545 (White, J., concurring). Douglas also noted the evidence of the exodus and suggested offering each child his preference about whether or not to continue his education. *Id.* at 1548 (Douglas, J., dissenting in part).

[48]Only one or two years of compulsory education are lost since the pertinent Wisconsin statute compels education only to age sixteen. *See* note 4 *supra*.

children would seem to be necessary. Allowing a child to make his own decision is not a viable alternative where the religion and way of life of a devout sect stand firmly against further formal education.

Quite obviously the majority opinion in *Yoder* did not consider the rights of the children. A dissenting opinion in the Wisconsin Supreme Court decision suggested that a *guardian ad litem* should have been appointed to represent those interests,[49] and the suggestion has merit. The Supreme Court might well have ruled the same way had the children been represented, especially since the rights of the two groups of children are almost equally balanced.[50] Nevertheless, because the case was decided without accounting for this crucial aspect of the case, the Court made its important ruling in a practical vacuum.[51]

W. KIMBALL GRIFFITH

Constitutional Law—Standards for the Right to Speedy Trial

The right to speedy trial, guaranteed by the Constitution,[1] has seldom been dealt with by the United States Supreme Court. It was not until 1967 with the case of *Klopfer v. North Carolina*[2] that the right to speedy trial was established as "fundamental" and applied to the states through the due process clause of the fourteenth amendment. Concurring in *Dickey v. Florida*,[3] Justice Brennan subsequently pointed out that the Court had never attempted to set standards by which the right to speedy trial is to be judged. In the recent case of *Barker v. Wingo*,[4] the Supreme Court undertook the task of providing constitutional guidelines to be used by both state and federal courts in assessing this

[49]49 Wis. 2d at 452 n.1, 182 N.W.2d at 549 n.1 (Heffernan, J., dissenting).

[50]The rights of those who lose the two years of education seem to be more substantial to this writer; even this small additional factor might warrant a different result.

[51]*See generally* Dixon, *Religions, Schools and the Open Society: A Socio-Constitutional Issue*, 13 J. PUB. L. 267, 304 (1964).

[1]U.S. CONST. amend. VI provides:

> In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence.

[2]386 U.S. 213 (1967), *noted in* 46 N.C.L. REV. 387 (1968).

[3]398 U.S. 30, 39 (1970).

[4]92 S. Ct. 2182 (1972).

important right. In *Barker* the Court refused to declare that the Constitution required the trial of a criminal case within any specific time limits[5] and adopted instead an *ad hoc* balancing test.[6]

Willie Barker and his accomplice, Silas Manning, were indicted on September 15, 1958, for the brutal murder of an elderly couple in Christian County, Kentucky. Although Barker's trial was set for October 21, 1958,[7] the prosecution did not believe that Barker could be convicted unless Manning testified against him. In order to preclude Manning from successfully asserting his fifth amendment right against self-incrimination when called as a witness to testify against Barker, Kentucky first sought to convict Manning in a separate trial.[8] After five trials Manning was finally convicted of the murder of one victim in March 1962.[9] Conviction for the murder of the other victim followed with a sixth trial in December 1962.[10]

In June 1959 after having spent ten months in jail, Barker obtained his release by posting a five thousand dollar bond, and he remained free until he was ultimately brought to trial. The Commonwealth requested and was granted eleven continuances in Barker's trial without objection from the defendant. Barker finally moved to dismiss the indictment after the Commonwealth asked for a twelfth continuance in February 1962.[11] The court denied Barker's motion to dismiss the indictment and granted the motion for the continuance.[12] The thirteenth and fourteenth continuances were subsequently granted without objection from Barker.[13]

After the conviction of Manning in December 1962, the Commonwealth moved to set Barker's trial for March 1963.[14] The fifteenth and sixteenth continuances were granted over Barker's objection due to the illness of the chief investigating officer in the case.[15] Finally, in October 1963, more than five years after his indictment, Willie Barker was brought to trial. With Manning as the chief prosecution witness, he was convicted and sentenced to life imprisonment.[16] The Kentucky Court of

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[5]*Id.* at 2188.
[6]*Id.* at 2192.
[7]*Id.* at 2185.
[8]Brief for Respondent at 2-3 & n.1, Barker v. Wingo, 92 S. Ct. 2182 (1972).
[9]92 S. Ct. at 2185.
[10]*Id.*
[11]*Id.*
[12]*Id.*
[13]*Id.*
[14]*Id.*
[15]*Id.* at 2185-86.
[16]*Id.* at 2186.

Appeals affirmed the conviction.[17]

In 1970 Barker petitioned the federal district court for a writ of habeas corpus. The court rejected the petition but granted Barker leave to appeal in forma pauperis. The decision was affirmed by the Court of Appeals for the Sixth Circuit.[18] The Supreme Court subsequently granted Barker's petition for certiorari.[19]

In affirming the conviction, a unanimous Supreme Court ruled that whether the right to speedy trial has been violated must be determined on a case-by-case basis. The Court indicated that the following factors should be considered: (1) the defendant's assertion of his right; (2) the prejudice to the defendant; (3) the length of the delay; and (4) the reason for the delay.[20]

In holding that the assertion by the accused[21] of his right to a speedy trial is only one factor to be considered, the Court has rejected the so-called "demand-waiver doctrine," which requires an accused to demand a speedy trial or waive his right thereto.[22] The Court felt that the "demand-waiver doctrine" was inconsistent with its holdings which have refused to uphold waivers of other constitutionally protected rights on the basis of acquiescent conduct by an accused.[23] For example, in *Boykin v. Alabama*,[24] the Court reversed the conviction of a defendant because the record failed to show that his guilty plea was intelligently and voluntarily made. The right to assistance of counsel as similarly guaranteed in *Carnley v. Cochran*[25] unless it were waived intelligently and understandingly.[26]

The United States Court of Appeals for the Second Circuit has established specific time limits within which criminal defendants must

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[17]Barker v. Commonwealth, 385 S.W.2d 671 (Ky. 1964).

[18]442 F.2d 1141 (6th Cir. 1971).

[19]404 U.S. 1037 (1972).

[20]92 S. Ct. at 2192.

[21]In United States v. Marion, 404 U.S. 307 (1971), the Court held that the sixth amendment right to speedy trial is applicable only after a person has in some way become an accused and that those not yet accused are protected by the applicable statute of limitations.

[22]*See, e.g.*, United States v. Perez, 398 F.2d 658 (7th Cir. 1968), *cert. denied*, 393 U.S. 1080 (1969); United States v. Lustman, 258 F.2d 475, 478 (2d Cir.), *cert. denied*, 358 U.S. 880 (1958), where the "demand-waiver doctrine" was applied.

[23]"We reject, therefore, the rule that a defendant who fails to demand a speedy trial forever waives his right." 92 S. Ct. at 2191.

[24]395 U.S. 238 (1969).

[25]369 U.S. 506, 516 (1962), "Presuming waiver from a silent record is impermissible."

[26]*But cf.* Illinois v. Allen, 397 U.S. 337 (1970), in which the defendant, through his disruptive behavior in the courtroom during his trial, lost his right to confront witnesses under the sixth and fourteenth amendments.

be brought to trial in the district courts of the Second Circuit.[27] Specific time limits within which an accused must be brought to trial have also been recommended by the American Bar Association[28] and are required by statute in many states. Some state statutes require that the accused be brought to trial within a specific number of days or months[29] or court terms.[30]

Interestingly, in *Barker* the Court made no mention of its amendment of rule 50(b) of the Federal Rules of Criminal Procedure in April 1972.[31] This amendment, effective October 1, 1972, was promulgated under the supervisory power of the Court and requires all federal district courts to:

> prepare a plan for the prompt disposition of criminal cases which shall include *rules relating to time limits* within which procedures prior to trial, the trial itself, and sentencing must take place, means of reporting the status of cases, and such other matters as are necessary or proper to minimize delay and facilitate the prompt disposition of such cases.[32]

In refusing to impose specific time limits as a constitutional requirement in *Barker,* the Court concluded that to proclaim judicially such limits would involve it in action more appropriate for the legislative branch of the government.[33] The Court also referred to *United States*

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[27]2D CIR. R. REGARDING PROMPT DISPOSITION OF CRIMINAL CASES provides in part:

> In all cases the government must be ready for trial within six months from the date of the arrest, service of summons, detention, or the filing of a complaint or a formal charge upon which the defendant is to be tried (other than a sealed indictment), whichever is earliest. If the government is not ready for trial within such time, or within the periods as extended by the district court for good cause under Rule 5, and if the defendant is charged only with non-capital offenses, then, upon application of the defendant or upon motion of the district court, after opportunity for argument, the charge shall be dismissed.

Rule 5 gives the periods of delay which are to be excluded in determining the six month period. *See* Statement of the Circuit Council to Accompany Second Circuit Rules Regarding Prompt Disposition of Criminal Cases, Appendix, 28 U.S.C.A. (1972 Supp.).

[28]ABA, PROJECT ON MINIMUM STANDARDS FOR CRIMINAL JUSTICE, STANDARDS RELATING TO SPEEDY TRIAL §§ 2.1-.3 (1967).

[29]*E.g.,* ILL. ANN. STAT. ch. 38, § 103-5(a) (Smith-Hurd 1970) (120 days from arrest); IOWA CODE ANN. §§ 795.1-.2 (Supp. 1972) (30 days from date held to answer to indictment; 60 days from indictment to trial).

[30]*E.g.,* W. VA. CODE ANN. § 62-3-21 (1966).

[31]*Reported,* 11 CRIM. L. REP. 3009 (1972).

[32]*Id.* at 3014 (emphasis added).

[33]The Court stated: "But such a result would require this Court to engage in legislative or rulemaking activity, rather than in the adjudicative process to which we should confine our efforts." 92 S. Ct. at 2188.

v. Ewell[34] where it warned of a deleterious effect upon the interests of both the accused and society if a requirement of unreasonable speed were imposed as a constitutional mandate upon the nation's trial courts.[35]

The Court in *Barker* identified three interests of the accused that should be assessed in determining prejudice: (1) prevention of oppressive pretrial incarceration; (2) minimization of the anxiety and concern of the accused; and (3) limitation of the possibility that the defense will be impaired.[36] After weighing these factors in the *Barker* case, the Court found it "clear that the length of delay between arrest and trial—well over five years—was extraordinary"[37] but that there was no violation of Barker's constitutional rights since the prejudice was minimal,[38] and most importantly, because Barker apparently did not want a speedy trial.[39]

This holding seems to have relegated the right to speedy trial to a level inferior to other sixth amendment rights. For instance, right to counsel has been upheld even without a showing of actual prejudice.[40] Similarly, denial of the right to confront witnesses is constitutional error which lack of prejudice will not cure.[41] In the principal case, the Court's finding that there was only minimal prejudice to the defendant's interest is at least questionable. It has been validly asserted "that memories fade, evidence is lost, and the burden of anxiety upon any criminal defendant increases with the passing of months and years."[42] The ravages of time might not be evident in the record of the case on appeal, but there can be little doubt of their potentially grave prejudicial effect on the defendant's case.[43]

The right to speedy trial may be undergoing the same evolutionary process as other sixth amendment rights. For example, in *Duncan v. Louisiana,*[44] the Court extended the sixth amendment right to trial by

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[34]383 U.S. 116 (1965).

[35]"A requirement of unreasonable speed would have a deleterious effect both upon the rights of the accused and upon the ability of society to protect itself." *Id.* at 120.

[36]92 S. Ct. at 2193.

[37]*Id.* at 2193-94.

[38]*Id.* at 2194.

[39]*Id.* The Court felt Barker was counting on Manning being acquitted, and the state then dropping the charges against him.

[40]Williams v. Kaiser, 323 U.S. 471, 475 (1945). *But cf.* Coleman v. Alabama, 399 U.S. 1 (1970).

[41]Brookhart v. James, 384 U.S. 1 (1966).

[42]United States v. Mann, 291 F. Supp. 268, 271 (S.D.N.Y. 1968).

[43]*See* United States v. Provoo, 17 F.R.D. 183, 203 (D. Md.), *aff'd,* 350 U.S. 857 (1955).

[44]391 U.S. 145 (1968).

jury in criminal cases to state actions. The Court held that only petty offenses could be tried without a jury but did not draw a distinct line between petty and serious offenses.[45] Faced, in the jury trial context, with the same problem, as in the speedy trial context, of drawing a distinct line between the constitutional and unconstitutional, the Court declined to establish such restrictions at the first opportunity. Instead, it watched developments as the lower courts struggled with its nonspecific guidelines. Finally, pressed to supply a precise answer two years later in *Baldwin v. New York,*[46] the Court looked to a federal statute, section one, chapter eighteen of the United States Code, and adopted, as a constitutional standard for state as well as federal cases, its definition of a petty offense as one for which imprisonment is not authorized for more than six months.[47] Similarly, in *Barker* the Court may have declined to set precise time limits in order to be able to evaluate the action that will be taken by lower courts as they endeavor to apply the broad standards adopted in *Barker.* In a future case where the defendant claims that he has been denied the right to a speedy trial, the Court may again look to federal law for guidance and adopt the time limits which are being prepared pursuant to amended rule 50(b) of the Federal Rules of Criminal Procedure.

Another sixth amendment right which has undergone an evolutionary process is the right to counsel. In *Betts v. Brady,*[48] the Court found that whether or not a defendant had been denied due process of law, for want of counsel at his trial, depended on the totality of circumstances to be determined on a case-by-case basis. In *Gideon v. Wainwright,*[49] the Court overruled *Betts.* Justice Harlan in his concurring opinion in *Gideon* commented on the passing of the totality of circumstances rule.[50] The Barker standards, which require a case-by-case approach similar to the guidelines adopted in *Betts* and overruled in *Gideon,* could well meet the same fate.

The balancing test adopted by the Court makes no provision for society's interest in having those accused of criminal behavior brought swiftly before the courts. Although recognized by the Court,[51] this interest was not reflected in the standards adopted. This conclusion is illus-

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[45] *Id.* at 161-62.
[46] 399 U.S. 66 (1970).
[47] *Id.* at 71.
[48] 316 U.S. 455 (1942).
[49] 372 U.S. 335 (1963).
[50] *Id.* at 349.
[51] 92 S. Ct. at 2186.

trated by the facts of the *Barker* case, itself, in which a man accused of a brutal murder was free on bail for over four years. Society's interest is given greater emphasis in amended rule 50(b) of the Federal Rules of Criminal Procedure.[52]

In assessing the possible remedies which could be imposed where the right to speedy trial has been violated, the Court found dismissal to be the only possible alternative and called it "indeed a serious consequence because it means that a defendant who may be guilty of a serious crime will go free, without having been tried."[53] The Court considered dismissal to be more drastic action than the exclusion of illegal evidence under the fourth amendment.[54] However, this conclusion does not seem to consider the fact that many cases reversed under the exclusionary rule are never retried because the prosecutor realizes that he cannot secure a conviction without the excluded evidence. In those cases where the defendant is not retried, the charges have, in effect, been dismissed.

The development of the right to a speedy trial continues to lag behind other constitutional protections afforded to the criminal defendant. The Supreme Court in *Barker* has taken a step toward full protection of this right, but until explicit time limits are established, a substantial risk of violation of this important right will remain in our system of criminal justice.

FRED C. THOMPSON, JR.

Environmental Law—Expanding the Definition of Public Trust Uses

Public concern for protecting the environment has recently been manifested in efforts to preserve the coastal wetlands.[1] Public pressure has resulted in the passage of comprehensive coastal zone management acts in three states[2] and a variety of less comprehensive measures in a

[52]FED. R. CRIM. P. 50(b), *reported,* 11 CRIM. L. REP. 3014-15, provides in part: "The district plan shall include special provisions for the prompt disposition of any case in which it appears to the court that there is reason to believe that the pretrial liberty of a particular defendant who is in custody or released pursuant to Rule 46, poses a danger to himself, to any other person, or to the community."

[53]92 S. Ct. at 2188, *see* ABA, *supra* note 28, § 4.1.

[54]92 S. Ct. at 2188.

[1]See E. BRADLEY & J. ARMSTRONG, A DESCRIPTION AND ANALYSIS OF COASTAL ZONE AND SHORELAND MANAGEMENT PROGRAMS IN THE UNITED STATES (Univ. of Michigan Sea Grant Technical Report No. 20, 1972).

[2]FLA. STAT. ANN. §§ 161.011-.45 (Supp. 1972); R.I. GEN. LAWS ANN. §§ 46-23-1 to -12

large number of other states.[3] One problem faced by legislatures when attempting to rationalize, coordinate, and control use of coastal wetlands is that by attempting too much regulation they may encroach upon property owners' rights protected by the fifth amendment's[4] prohibition against taking property without just compensation.[5] The recent California decision, *Marks v. Whitney*,[6] provides California (and any other state in which a public trust in coastal, tideland, or navigable waters is recognized) with a useful and creative means of avoiding the "takings" problems when legislating for wetlands management.

Marks owned property on Tomales Bay, a bay affected by the tides. A remote predecessor in title had received the property by grant from the state. A long strip of his property consisted of land covered by the ordinary ebb and flow of tides—that is, tideland. Whitney's property was landward of Marks' and was so situated that Marks' tidelands separated almost all of Whitney's beachfront from the waters of the bay. Marks proposed to cut off or substantially diminish Whitney's free access to the waters by constructing a boating marina along the entire length of his tideland property.

Perhaps for the purpose of obtaining financing for his project, Marks instituted an action to quiet title in which he asserted "complete ownership of the tidelands and the right to fill and develop them."[7] Whitney counterclaimed alleging a right to free access to the waters upon which his land fronted. He based his claim on rights accruing to himself as a littoral owner and as a member of the public. His public claim was based on California law, which holds tidelands to be public trust lands burdened with public-trust easements.[8]

(Supp. 1970); WASH. REV. CODE ANN. § 90.286x (Supp. 1971). In about half of the remaining coastal states major studies of coastal wetlands have been undertaken. *See* E. BRADLEY & J. ARMSTRONG, *supra* note 1, at 58.

[3]*Id.* at 9-18.

[4]U.S. CONST. amend. V. In Chicago, B.&Q.R.R. v. Chicago, 166 U.S. 226, 235-41 (1897), the Supreme Court held that taking of private property for public purpose without compensation is a denial of due process forbidden by the fourteenth amendment.

[5]Schoenbaum, *The Coastal Zone, Public Rights and Coastal Zone Management*, 51 N.C.L. Rev. 1 (1972).

[6]6 Cal. 3d 251, 491 P.2d 374, 98 Cal. Rptr. 790 (1971).

[7]*Id.* at 256, 491 P.2d at 377, 98 Cal. Rptr. at 793.

[8]The landmark cases are People v. California Fish Co., 166 Cal. 576, 138 P. 79 (1913), and Forestier v. Johnson, 164 Cal. 24, 127 P. 156 (1912). California public trust law holds that, with certain exceptions based on statutory interpretations of legislative acts of the late nineteenth century, the tidelands of the state are held by the state in trust for the people. Any conveyance of the tidelands by the state to a private individual reserves by implication a public-trust easement to the state unless the legislature affirmatively extinguishes the trust with regard to the land conveyed.

The trial court denied that Whitney had standing to raise the public trust issue. It disposed of Whitney's claim to access based on his rights as a littoral owner by granting him a seven-foot-wide easement across Marks' property. The California Court of Appeal affirmed the trial court's decision.[9] Whitney appealed to the California Supreme Court.

The supreme court addressed itself to four questions:[10] the first considered whether Marks' tidelands were burdened with a public servitude; the second dealt with Whitney's standing to raise the public trust issue; the third discussed Whitney's rights as a littoral owner; the fourth involved the problem of how to fix the seaward boundary of Marks' property. Only the language used by the Court in answering the first question is pertinent to the constitutional problem of "takings" inherent in most comprehensive land-use regulatory schemes.

Not surprisingly, the supreme court found that Marks' tidelands were burdened with a public trust easement. This finding was consistent with many previous cases in which the courts had found the state's tidelands to be burdened with a public servitude.[11] The court did not stop, however, with declaring the existence of the burden; it went on to address itself to the problem of defining the scope of the servitude. Public trust easements in coastal waters and tidelands, the court explained, had been traditionally defined in terms of navigation, commerce, and fisheries.[12] This categorization was not, however, exclusive. Other uses, particularly recreational uses, had been recognized as falling within the public trust servitude.[13] The court noted that tradition should not be mistaken for law and that certain uses should not be favored merely because they had been favored in the past.

> In administering the trust the state is not burdened with an outmoded classification favoring one mode of utilization over another. . . . There is a growing public recognition that one of the most important public uses of the tidelands—a use encompassed within the tidelands trust—is the preservation of those lands in their natural state, so that they may serve as ecological units for scientific study, as open space, and as environments which provide food and habitat for birds and

[9] 11 Cal. App. 3d 1089, 90 Cal. Rptr. 220, *petition for rehearing denied*, 12 Cal. App. 3d 796, 91 Cal. Rptr. 128 (1970).

[10] 6 Cal. 3d 251, 491 P.2d 374, 98 Cal. Rptr. 790.

[11] People v. California Fish Co., 166 Cal. 576, 138 P. 79 (1913); Forestier v. Johnson, 164 Cal. 24, 127 P. 15 (1912).

[12] 6 Cal. 3d at 259, 491 P.2d at 380, 98 Cal. Rptr. at 796.

[13] *Id.*

marine life, and which favorably affect the scenery and climate of the area.[14]

The notion that public rights exist in navigable and tidal waters is ancient in Anglo-American law;[15] indeed, its origins have been traced to Roman law.[16] The reasons for the development of a body of law dealing with public rights in waters are the subject of historical debate,[17] but they probably include the importance of water as a resource, the competition for this resource, and the waxings and wanings of monarchical power in England.[18] By the late eighteen century the state of the public trust law in England was essentially this: navigable waters,[19] whether owned by the sovereign or by private persons, were impressed with a servitude in favor of the public. Regardless of who held legal title to the land under the water, the public had certain rights to the use of the water which the sovereign was supposed to enforce[20] for the benefit of the public. The most ancient and frequently enunciated of these rights was the right of navigation. Two other easements mentioned almost as frequently were the right of commerce and the right of fishery.[21]

When the American states gained independence from England, trusteeship passed from the British sovereign to each of the states. An early United States Supreme Court decision, *Martin v. Waddell*,[22] held that a state could, if it wished, assert its trusteeship to navigable waters, that is, the question was a matter of state law. This holding plus several other nineteenth century decisions[23] seemed to imply that a state legislature might ignore the state's trusteeship and systematically alienate the navigable waters of the state to private parties free from the public

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[14]*Id.* at 259-60, 491 P.2d at 380, 98 Cal. Rptr. at 796.

[15]A.W. Stone, *Public Rights and Private Rights in Land Adjacent to Water*, in 1 WATERS AND WATER RIGHTS § 35.2 (R. Clark ed. 1967).

[16]*See Note—State Citizen Rights Respecting Greatwater Resource Allocation: From Rome to New Jersey*, 25 RUTGERS L. REV. 571, 576 (1971) [hereinafter cited as *Greatwater Resource*]; Comment, *The Public Trust in Tidal Areas: A Sometime Submerged Traditional Doctrine*, 79 YALE L.J. 762, 763 (1970) [hereinafter cited as Comment].

[17]*Greatwater Resource* 577 & n.28.

[18]For a good short survey of the development of public trust law in England *see id.* at 576-99.

[19]The definition of "navigable" has caused considerable confusion in American case law. *See* Schoenbaum, *supra* note 5.

[20]Roman law favored the theory that the sovereign could not alienate title to the beds under navigable waters at all. English common law, however, permitted alienation of title but found an implied easement in favor or public rights in the waters regardless of who held title to the subsoil. Comment 768-71.

[21]*Id.* at 781, 783.

[22]41 U.S. (16 Pet.) 367 (1842).

[23]Pollard's Lessee v. Hagan, 44 U.S. (3 How.) 212 (1845); Barney v. City of Keokuk, 94 U.S. 324 (1876).

servitude. But to confuse matters, at the close of the nineteenth century in the great public trust case, *Illinois Central Railroad Co. v. Illinois*,[24] the United States Supreme Court seemed to reverse itself and indicate that a state could not completely abdicate its responsibilities as trustee for the public of navigable waters within its domain.

The legacy of confusion from the nineteenth century concerning the existence and nature of the public servitude to which the nation's waters are subject has resulted, in this century, in much litigation. One of the most interesting and important questions litigated is the one raised by *Marks v. Whitney*: What is a public trust use?

As already noted, the court was correct in stating that the legitimate and protected public trust uses of tidelands have most frequently been defined in terms of navigation, commerce, and fisheries.[26] This was certainly true in California. An early California case, *Eldridge v. Cowell*,[27] perhaps limited public trust rights to navigation. Several years later the right of fishery was mentioned as a protected public trust use.[28] Following the landmark public trust decision by the United States Supreme Court in *Illinois Central Railroad Co. v. Illinois*,[29] in which navigation, fishery, and commerce were all mentioned as being legitimate public trust uses, the California Supreme Court as a routine matter began to incorporate the trio of uses into its enunciation of protected public trust usage.[30]

A few years ago, however, a new note crept into the California court's discussion of the nature of public trust usage:

> The nature and extent of the trust under which the state holds its navigable waterways has *never been defined with precision*, but it has been stated generally that . . . [uses] . . . are within trust purposes when they are done "for the purposes of commerce, navigation, and fisheries for the benefit of all the people of the state."[31]

In *City of Long Beach v. Mansell*[32] the trio of uses were described as

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[24]146 U.S. 387 (1892).

[25]Stone, *supra* note 15, at 200.

[26]*See* note 20 *supra*.

[27]4 Cal. 87 (1854).

[28]Ward v. Mulford, 32 Cal. 353 (1867).

[29]146 U.S. 387 (1892).

[30]*See, e.g.*, People v. California Fish Co., 166 Cal. 576, 138 P. 79 (1913); Forestier v. Johnson, 164 Cal. 24, 127 P. 156 (1912).

[31]Colberg, Inc. v. State, 67 Cal. 2d 408, 417, 432 P.2d 3, 9, 62 Cal. Rptr. 401, 407 (1967) (emphasis added).

[32]3 Cal. 3d 462, 476 P.2d 423, 91 Cal. Rptr. 23 (1970).

the "traditional" delineation of public trust purpose. The court was beginning to consider the possibility that navigation, fisheries, and commerce were not the only usages to come within the aegis of public trust. In *Marks v. Whitney* the court has finally stopped hinting that the trio is not sacred and actually has suggested a few new uses that fall within the scope of the public trust easement and deserve the status of public trust use. In recent years only two other state courts have spoken with such expansiveness of the scope of the public trust easement.[33] In *Menzer v. Elkhart Lake*,[34] the Wisconsin Supreme Court quoted with approval an earlier Wisconsin decision in which that court had said:

> The wisdom of the policy which, in the organic laws of our state, steadfastly and carefully preserved to the people the full and free use of public waters cannot be questioned. Nor should it be limited or curtailed by narrow constructions. It should be interpreted in the broad and beneficent spirit that gave rise to it in order that the people may fully enjoy the intended benefits.[35]

The Wisconsin court has led the nation in developing a comprehensive body of law based on the public trust.[36]

Recently, the New Jersey Supreme Court joined California and Wisconsin in announcing new vistas for the doctrine. In *Borough of Neptune City v. Borough of Avon-by-the Sea*,[37] the court decided that the public trust doctrine prohibited municipalities from charging higher rates to non-residents than to residents attempting to use the city's beaches. Plaintiffs had not argued the public trust as a theory of recovery; the court supplied the rationale on its own.[38] Like California, the New Jersey court observed that the traditional delineations of public trust usage, navigation, fishing, and commerce, were no longer adequate to meet the current needs.

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[33]One other court, the Massachusetts Supreme Court, declared more than fifty years ago that the scope of the public trust doctrine went beyond navigation: "it includes all necessary and proper uses, in the interest of the public." Home for Aged Women v. Commonwealth, 202 Mass. 422, 435, 89 N.E. 124, 129 (1909). However, this expansive language has not been further developed by the Massachusetts court, although with regard to other issues concerning the public trust (alienability, for example) Massachusetts has developed a comprehensive body of law. *See* Sax, *Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV. 471, 491 (1970).

[34]51 Wis. 2d 70, 82, 186 N.W.2d 290, 296 (1971).

[35]Diana Shooting Club v. Husting, 156 Wis. 261, 271, 145 N.W. 816, 820 (1914).

[36]Sax, *supra* note 33, at 509.

[37]61 N.J. 296, 294 A.2d 47 (1972).

[38]*Id.* at ____, 294 A.2d at 51.

> We have no difficulty in finding that, in this latter half of the twentieth century, the public rights in tidal lands are not limited to the ancient prerogatives of navigation and fishing, but extend as well to recreational uses, including bathing, swimming and other shore activities. The public trust doctrine, like all common law principles, should not be considered fixed or static, but should be molded and extended to meet changing conditions and needs of the public it was created to benefit.[39]

Of what benefit is this broadened concept of public trust use enunciated in *Marks v. Whitney* to persons concerned with rationalizing and coordinating the resource use of the coastal wetlands? The answer depends on the influence of the California Supreme Court with the various state courts and legislatures of the nation. The court has issued a clear invitation to the California legislature to use the public trust doctrine aggressively. The legislature can do this by incorporating into legislation the finding by the court that uses of coastal wetlands for ecological conservation, open-space, and scientific study come under the umbrella of the public trust servitude with which the wetlands are burdened.

Public trust law is not a sophisticated or well-coordinated branch of the substantive law.[40] The use of wetlands for navigation, fishery, or commerce may conflict with one of the other public trust uses. For example, dredging a harbor may be beneficial for commerce and navigation but disastrous to fisheries. In 1967 the California Supreme Court found drilling for oil and gas in the tidelands to be consistent with the public trust because the activity was so obviously related to commerce.[42] The confusion in public trust law derives partly from state legislatures' leaving to the courts the role of defining public trust use and of establishing a hierarchy of preferred uses.[43] The courts, left to fashion the law from a hodgepodge of fact situations, have understandably been unable to formulate a comprehensive body of law.

If the California legislature is not interested in breaking the unblemished record of legislative abstinence from public trust law, the language in *Marks v. Whitney* may simply be interpreted as adding

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[39]*Id.* at ____, 294 A.2d at 54.

[40]Comment 774.

[41]Some writers claim that in a showdown navigation always wins. *See id.* at 774; *Greatwater Resource* 649.

[42]Colberg, Inc. v. State, 67 Cal. 2d 408, 418, 432 P.2d 3, 9, 62 Cal. Rptr. 401, 407 (1967).

[43]For a general discussion of what some jurisdictions have done toward developing comprehensive public trust doctrine in the absence of statutes pertaining to the subject *see* Sax, *supra* note 33.

another few "uses" to the general potpourri. The trio becomes a quintet or something more; "ecological preservation" and "scientific study" join navigation, commerce, and fishery. Public and private plaintiffs simply have another peg on which to hang an environmental law suit.[44] Courts will be obliged to continue the haphazard balancing of competing public trust uses according to their relative importance, except that five or six uses will have to be juggled now instead of three.

This discussion is not intended to disparage the utility to environmental plaintiffs of the addition of some new uses to those already deserving of protection. However, legislation which is responsive to the broad language in *Marks v. Whitney* would provide a far more powerful aid to efforts to preserve coastal wetlands. The legislature, in its role as trustee for the public of public trust easements in the wetlands, should simply declare that the use of the wetlands, most beneficial to the public is the preservation of the wetlands as ecological units of study, as open-space, and as a natural environment for birds and marine life. Any proposed uses, including other public trust uses, which are inconsistent with these should be declared permissible only upon a showing that such other uses will not substantially impair or harm the uses now given priority. Any present use of public trust areas inconsistent with the priority uses should be declared permissible only upon a finding by an administrative agency that such uses are necessary to and for the benefit of the public as a whole or do not substantially impair the uses of the wetlands now deemed to hold priority.

Obviously such legislation is very broad in scope. An act by the California legislature along the lines suggested above should not be the legislature's final effort with regard to coastal zone management. More comprehensive measures, such as those passed in Florida and Washington,[45] are clearly preferable for dealing with resource utilization of wetlands. As a stop-gap measure, however, such legislation would at least prevent heedless and unnecessary destruction of the coastal wetlands.

How does the holding in *Marks v. Whitney* enable the legislature to avoid the constitutional problem of takings? First, a brief explanation of what this problem involves: The United States Constitution[46] and most state constitutions[47] provide that no property shall be taken for

[44]Professor Joseph Sax sees great possibilities for protection of the environment via citizen law suits brought to defend the public trust. *See* J. SAX, DEFENDING THE ENVIRONMENT 158-74 (1971).

[45]*See* note 2 *supra*.

[46]U.S. CONST. amend. V; *see* note 4 *supra*.

[47]*E.g.*, CAL. CONST. art. 1 § 14; N.Y. CONST. art. 1 § 7.

public purpose without just compensation. Occasionally land-use planning schemes involve limiting the use to which a private owner may put his property to such an extent that the owner is deprived of all reasonable beneficial enjoyment. When this happens, the plan or scheme is said to be unconstitutional as to that particular owner since to hold otherwise would, in effect, permit state action to "take" a person's property without compensation.[48] A coastal management scheme that contemplates conserving vast areas of the wetlands could encounter difficulties from riparian owners whose lands were rendered useless or nearly so by the restrictions placed on their property. These owners could argue that either the plan was unconstitutional as to them or that conformity with the plan required the state to compensate them for the loss of enjoyment of their property.[49] Success of the former argument would effectively gut the plan; success of the latter could be prohibitively expensive for the state. *Marks v. Whitney* reveals one kind of activity, however, in which the government can engage, even to the extent of severely restricting the use to which riparian owners may put the waters abutting their property, that does not require compensation to those owners. The government, as sovereign and as trustee of the public easement in navigable and tidal waters, may engage in activity for the protection of whatever uses are deemed to fall within the definition of public trust. In doing so the government is not "taking" anything; it is using what it already owns.[50] As mentioned above,[51] the most traditional use has been navigation, and most of the cases that deal with this issue speak of the government activity in terms of navigation or of commerce.[52] But, using the reasoning of *Marks v. Whitney*, the easement is viewed as a functional one based on current findings of beneficial public use rather than an historical classification of certain immutable uses. Therefore, as the government finds certain uses to be more pressing and others less so, the use

[48]In Zabel v. Pinellas County Water & Navig. Control Authority, 171 So. 2d 376 (Fla. 1965), the Florida Supreme Court held that absent a showing of adverse effect to the public interest, defendant's denial of a dredge and fill permit to plaintiff, which prevented plaintiff from fulfilling his dream of constructing a trailer park on Boca Ciega Bay, amounted to taking plaintiff's property without compensation.

[49]*Id.*

[50]*See* Sage v. Mayor, Aldermen & Commonality, 154 N.Y. 61, 79-80, 47 N.E. 1096, 1101-02 (1897), for explanation for finding a retention of an easement for the public in any conveyance of public trust lands by the sovereign, on the basis of the principle of implied reservation.

[51]*See* text accompanying note 21 supra.

[52]*See, e.g.*, Scranton v. Wheeler, 179 U.S. 141, 171 (1900); United States v. 422,978 Square Feet of Land, 445 F.2d 1180, 1184, (1971); *In re* Jamaica Bay, 286 N.Y. 382, 176 N.E. 539, 542 (1931).

to which the government may put its easement may change accordingly. If what the government wishes to do with its easement is to restrict use of public trust property altogether, that is, to preserve the property in its natural state, riparian owners cannot complain that something has been taken from them. Whatever rights they had, whatever the nature of their ownership in the soil under the water, they took their property subject to the public easement.[53]

There is room for much abuse if the government carries the public trust rationale too far. On one hand, there must be limits to the type of use the government wishes to make of its easement. If the legislature were to find, for example, that the most pressing public need with respect to tidal waters was to derive revenue from their sale, other aspects of public trust law must intervene to prohibit the destruction of the trust.[54] On the other hand, the legal theory of public trust easement whereby the government can prohibit development of wetlands areas by owners in fee of the subsoil will leave many persons who have made substantial investments in coastal property with very little to show for their expenditure and probably very little in the way of remedy. For these reasons, fairness dictates that the avenue opened by *Marks v. Whitney* be taken as merely a stopgap approach to the prevention of wetlands destruction.

MARIANNE K. SMYTHE

Estate Tax and the Closely Held Corporation—A Nearly Fatal Blow to Section 2036

Many a tax consultant who has a client with a majority interest in a closely held corporation has been looking for a way for his client to avoid estate taxes on such stock without having to give up control of his corporation in the process. In *United States v. Byrum*[1] the Supreme Court has provided such an opportunity. According to the Court's interpretation of section 2036 of the Internal Revenue Code,[2] the majority

[53]In Zabel v. Pinellas County Water & Navig. Control Authority, 171 So. 2d 376, 388 (Fla. 1965), the dissenting opinion found "the retained inalienable trust doctrine" to be sufficient grounds to deny compensation to an owner of the tidelands denied a permit to dredge and fill.

[54]Professor Sax devotes much of his article, *supra* note 33, to the problem of preserving the public-trust servitude in spite of legislative indifference and hostility.

[1]92 S. Ct. 2382 (1972).

[2]INT. REV. CODE OF 1954, § 2036 provides:

stockholders of closely held corporations will be able to have their cake and eat it, too. The majority stockholder may now put his stock in trust, retain the voting rights, and retain control over disposition of any assets in the trust, which enables him to maintain control over his corporation without fear that the stock will be included in his gross estate for federal estate tax purposes.

The decedent in *Byrum* created an irrevocable trust to which he transferred a portion of his shares of stock in three closely held corporations.[3] The trusts were created for the benefit of his children or, in the event of their death before the termination of the trust, his grandchildren. An independent corporation was designated as the sole trustee with broad and detailed powers to administer and control the trust property in its sole discretion, subject to the rights reserved by the decedent to vote all shares of stock in the trust, to disapprove the sale or transfer of any trust assets, to approve investments and reinvestments, and to remove the trustee and designate another corporate trustee to serve as successor. The Commissioner of Internal Revenue included the value of the transferred shares in the decedent's gross estate on the grounds that the retained control of the corporations gave the decedent continued employment, remuneration, and the right to determine whether the corporations would be liquidated or merged.[4] These retained benefits gave the decedent the "possession and enjoyment" required under section 2036(a)(1).[5] In addition, the Commissioner included the stock under section 2036(a)(2), concluding that the retained

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(a) GENERAL RULE—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

[3]The percentage ownership after transfer was as follows:

	Percentage owned by Decedent	Percentage owned by the Trust	Total by Both
Byrum Lithographing Co., Inc.	59%	12%	71%
Graphic Realty, Inc.	35%	48%	83%
Bychrome Co.	42%	46%	88%

92 S. Ct. at 2387 n.2.

[4]*Id.* at 2395.

[5]*See* note 2 *supra.*

right to vote the stock and to veto any stock transfer by the trustee enabled the decedent to maintain control over corporate dividend policy, thus enabling the decedent to shift or defer the beneficial enjoyment of the trust income between present income beneficiaries and remaindermen. The Court rejected the Commissioner's arguments for inclusion under both subsections in a six-to-three decision. The Court's opinion on the application of each sub-section will be examined in turn.

First, the Court held that reserving management powers over the trust without more was not enough to qualify under the "possession and enjoyment" provision of section 2036(a)(1).[6] The *Byrum* Court distinguished "possession and enjoyment" of the "property" from "control" of the corporation. The government conceded that the mere retention of the right to vote shares did not constitute the type of "possession and enjoyment" contemplated by the statute. However, they argued that control was covered by the statute. The Court's response was that Byrum transferred only stock, not "control," because the trust never owned as much as fifty percent of the stock of any one corporation.[7] The Court said that he retained not "income from or the use of the property,"[8] but control of the corporation by retaining the right to vote the shares he owned and those he placed in trust.[9]Because control was not an attribute of property that was given up, the stock was not includible.[10] The Court said, "The statutory language plainly contemplates retention of an attribute of the property transferred—such as a right to income, use of the property itself, or a power of appointment with respect either to income or principal."[11] However, even if "control" had been considered "property" and thereby had been covered by section 2036(a)(1), the necessary criteria for inclusion would still not have been met.[12] "Enjoyment" has been defined as connoting a "substantial present economic benefit."[13] The Court could find no "substantial present

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[6]92 S. Ct. at 2395.

[7]*See* note 3 *supra.*

[8]92 S. Ct. at 2396-97.

[9]*Id.* at 2396. Only when the decedent retains the income from or the use of the property is it included. United States v. Estate of Grace, 395 U.S. 316 (1969); Commissioner v. Estate of Church, 335 U.S. 632 (1949); Estate of McNichol v. Commissioner, 265 F.2d 667 (3d Cir.), *cert. denied*, 361 U.S. 829 (1959). *But see* Estate of Pamela D. Holland, 1 T.C. 564 (1943).

[10]"Indeed, at the time of his death he still owned a majority of the shares in the largest of the corporations and probably would have exercised control of the other two by virtue of being a large stockholder in each." 92 S. Ct. at 2397.

[11]*Id.* at 2397.

[12]*Id.*

[13]Commissioner v. Estate of Holmes, 326 U.S. 480, 486 (1946); *see, e.g.*, Estate of McNichol

economic benefit" retained by Byrum in his power to liquidate or merge the corporation, since this right was not a "present" benefit. In addition, the Court said that the restrictions imposed on Byrum by the Internal Revenue Service[14] and his "fiduciary duty" to minority stockholders[15] were sufficient to prevent any substantial benefit from his continued employment and compensation.[16]

The government's primary contention was that the decedent's control of the dividend policy of the corporations and control over the disposition of the stock itself enabled him to distribute the "possession and enjoyment" of the property between the income beneficiaries and the remaindermen. The *Byrum* Court disagreed, relying on two cases in which the decedent retained powers over the trust, *Estate of Willard V. King*[17] and *Reinecke v. Northern Trust Co.*,[18] which the Court stated involved retained powers essentially the same as Byrum's retained powers. Although neither of these cases was controlling,[19] the Court appeared to say that if a taxpayer had relied on the case law as he saw it, the courts would not overturn such a "principle of taxation."[20] In both of the cases there was no power to designate who should enjoy the

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v. Commissioner, 265 F.2d 667 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959); Yeazel v. Coyle, 68-1 U.S. Tax Cas. 87,384 (N.D. Ill. 1968).

[14]INT. REV. CODE OF 1954, § 162(a)(1) will not allow a tax deduction for a salary payment which is not an ordinary and necessary business expense.

[15]92 S. Ct. at 2393 n.18. Under Ohio law minority shareholders may bring derivative suits. OHIO R. CIV. P. 23.1.

[16]*See, e.g.*, Estate of William F. Hofford, 4 T.C. 790, *modifying* 4 T.C. 542 (1945). (even though the settlor retained control of the corporation through an employment contract, if he rendered services for the corporation and the compensation was reasonable then there would be no inclusion).

[17]37 T.C. 973 (1962). King created three trusts and transferred securities to a third party trustee. The income was to be paid to certain designated beneficiaries for life with remainders over to designated remaindermen. The trustee could exercise the rights of management and investment only in accordance with the directions of the settlor. The trust holdings of securities were at no time significant from the point of view of control of the particular companies involved. The trust assets were held non-includable in his gross estate.

[18]278 U.S. 339 (1929). In *Reinecke* the decedent created five trusts with life interests to the income designated in certain beneficiaries. He reserved the "power to supervise the reinvestment of trust funds, to require the trustee to execute proxies to his nominee, to vote" the shares held by the trust, and to control leases executed by the trustee. *Id.* at 344. The trust assets were held not includable in the decedent's gross estate since the mere retention of management powers will not render the trust includable in his gross estate.

[19]The Court recognized that neither of these cases was controlling since one was an unappealed Tax Court decision and the other was decided before the present § 2036 was enacted. However, they did carry weight as a reliance factor. 92 S. Ct. at 2389.

[20]*Id.* "Courts properly have been reluctant to depart from an interpretation of tax law which has been generally accepted when the departure could have potentially far-reaching consequences."

income from the transferred property.[21]

The majority also rejected the argument that *United States v. O'Malley*[22] compelled the inclusion of the trust. Byrum did not retain a right "to designate the person who shall possess or enjoy the property" as required by section 2036(a)(2).[23] The Court interpreted "right" as used in the statute as an "ascertainable and legally enforceable power."[24] O'Malley's legal right to accumulate or distribute the income in his discretion put him squarely within the net of section 2036.[25] According to the majority, Byrum reserved no right to tell the trustee how to distribute the income of the trust. Byrum's power to elect the directors of the corporations conferred no legal right to command the payment or nonpayment of dividends. In the view of the majority, the power to declare dividends is vested solely in the corporate board of directors, not with the majority stockholder. The dividend policy of the corporation is subject to business and economic considerations, the threat of derivative suits,[26] the sufficiency of retained earnings,[27] and the accumulated earnings tax.[28] The majority stockholder is also restricted by a fiduciary duty to the minority stockholders not to misuse his powers.[29] The government sought to equate this *de facto* position of a controlling stockholder with the "legally enforceable right" specified in the statute and applied in *O'Malley*. The majority, however, felt that the decedent was sufficiently restricted in his *de facto* power to eliminate any substantial benefit he might receive by his position; therefore, there was no

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[21]The two settlors in *King* and *Reinecke* did not have power to distinguish between the income beneficiaries or the remaindermen. The powers retained were management over the trust assets. The settlors did have control over any of the corporations whose stock was transferred to the trusts. The management powers alone did not permit the settlors to designate who shall enjoy the property. Reinecke v. Northern Trust Co., 278 U.S. 339, 344, 346 (1929); Estate of Willard V. King, 37 T.C. 973, 974, 980 (1962).

[22]383 U.S. 627 (1966). O'Malley created five irrevocable trusts in which he reserved the "right" in the trust agreement along with two other persons to accumulate the income in their sole discretion and thus was able to "designate" between the income beneficiaries and the remaindermen. The trust corpus and the accumulated income were held to be includible in his gross estate. *Id.* at 629, 634.

[23]92 S. Ct. at 2394.

[24]*Id.* at 2390.

[25]*See* note 22 *supra.*

[26]*See* note 15 *supra.*

[27]*See, e.g.*, CAL. CORP. CODE ANN. § 1500 (West Supp. 1971). For liability of directors see *id.* § 825 (West 1955).

[28]INT. REV. CODE of 1954, § 531 (an accumulated earnings tax penalty is imposed on the improper accumulation of surplus).

[29]H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 240 (2d ed. 1970).

inclusion.[30]

It is clear that an inter vivos transfer of stock in a closely held corporation which is qualified only by the settlor's implied retention[31] of control of the stock through his management of the corporation, without more, does not qualify as a taxable testamentary disposition.[32] The retention of management powers[33] or voting rights[34] of the stock in trust does not put the transfer within section 2036(a)(1) because these powers do not convey any direct benefit to the settlor. The trustee may still use the assets of the trust, including the stock, to benefit the income beneficaries because the settlor has not retained control over the use or disposition of the stock.[35] The majority relied heavily on *Reinecke v. Northern Trust Co.*[36] to support its holding; however, the dissent very clearly distinguished *Reinecke* from *Byrum* on its facts. The *Reinecke* settlor, through his shares of stock and those he could vote in trust, could not control any of the corporations whose stock was placed in trust.[37] The Court failed to recognize that Byrum's control and powers over the trust were more extensive than any of the fact situations in the cases cited by the majority.[38]

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[30]92 S. Ct. at 2394.

[31]Soled, *Estate Tax Consequences of Inter Vivos Transfers of Stock in a Closely-Held Corporation*, 31 MD. L. REV. 191, 221-25 (1971), gives a good discussion of the implied retention theory and how the government has attempted to utilize it.

[32]Section 2036 taxes inter vivos transfers when the objective intent or operation of the transfer is a testamentary disposition. The government has consistently argued for inclusion based on the management powers retained by a decedent over the corporation even though no direct control of the stock in trust was provided for. The courts have been uniform in rejecting this "implied" retention theory based solely on powers of management. *See, e.g.*, Gardner v. Delaney, 103 F. Supp. 610 (D. Mass. 1952).

[33]*See, e.g.*, Estate of William F. Hofford, 4 T.C. 790, *modifying* 4 T.C. 542 (1945).

[34]*See, e.g.*, Estate of Harry H. Beckwith, 55 T.C. 242 (1970), *acquiesced in*, 1971-1 CUM. BULL. 1.

[35]*Id.* The *Beckwith* trustee could still dispose of the stock and take back the voting rights of the stock in trust. These powers of the trustee prevented the settlor from effectively exercising any control over the disposition or accumulation of the income. They also prevented any benefit from accruing to the settlor.

[36]278 U.S. 339 (1929). It should be noted that this case was decided before the current § 2036 or its predecessor § 811(c) (Int. Rev. Code of 1939, ch. 3, § 811(c), 53 Stat. 121). *See* note 18 *supra*.

[37]92 S. Ct. at 2399 (White, J., dissenting).

[38]*Id.* at 2389 n.6; *see, e.g.*, Estate of Edward E. Ford, 53 T.C. 114 (1969), *aff'd*, 450 F.2d 878 (2d Cir. 1971) (settlor was named trustee with power to invade corpus; however, the trust assets were held not includable because there were sufficient "external standards" in the trust agreement); Estate of C. Dudley Wilson, 13 T.C. 869 (1949) (en banc), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951) (settlor had the power as trustee to accumulate or distribute the income, but this power was clearly defined by the trust agreement).

The Court would have done well to follow the example of *State Street Trust Co. v. United States*,[39] which held that even if the retained powers taken seperately would not require inclusion, the powers considered as a whole might be so all-inclusive as to mandate inclusion in the decedent's gross estate. The broad powers retained by Byrum would not allow a court of equity to effectively supervise the affairs of the trust so as to protect the income beneficiaries and the remaindermen. Since courts are hesitant to interfere with corporate management decisions[40] and the hands of the trustees were tied as to investment policies, there was no real power or standard that could have prevented Byrum from achieving a substantial benefit from the voting rights and control of the corporation. The *Byrum* Court, however, failed to recognize this distinction. When applied to the facts in *Byrum*, the *State Street* analysis would require a conclusion that the powers retained by Byrum were too broad to avoid inclusion under section 2036.[41] Consequently, the *Byrum* decision had gone further than any other in narrowing the inclusionary powers of the "possession and enjoyment" clause of section 2036(a)(1).[42]

The Court appears to have made a complete reversal of its position in *Commissioner v. Estate of Church*.[43] According to *Church*, the settlor must "absolutely, unequivocally, irrevocably, and without possible reservations part with all of his title and all of his possession and all of his enjoyment of the transferred property."[44] Byrum, for all practical purposes, had given up almost nothing by placing his corporate stock in trust. The stock in a closely held corporation conveys three principal benefits: control of the corporation, income from the stock as dividends, and a capital investment. The terms of the trust agreement and the application of those terms effectively shielded all of these benefits from

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[39]363 F.2d 635 (1st Cir. 1959).

[40]Murray, *Legal and Financial Aspects of Dividend Policy*, 23 BAYLOR L. REV. 7 (1971); Soled, *supra* note 31, at 217.

[41]*State Street* could be considered overruled by Old Colony Trust Co. v. United States, 423 F.2d 601 (1st Cir. 1970); however, the principle expounded in *State Street* is still used in the area of charitable estate tax deductions under the INT. REV. CODE OF 1954, § 2055(a)(2). *See, e.g.*, Estate of Stewart v. Commissioner, 436 F.2d 1281 (3d Cir. 1971). There is no reason why the same standard cannot also apply to § 2036.

[42]*See, e.g.*, Estate of Harry H. Beckwith, 55 T.C. 242 (1970) (trustee *gave* decedent the power to vote the stock in trust; trust stock held not includable since decedent could not restrict the trustee's freedom to vote or dispose of the stock); Estate of C. Dudley Wilson, 13 T.C. 869 (1949), *aff'd per curiam*, 187 F.2d 145 (3d Cir. 1951); Estate of George H. Burr, 14 P-H Tax Ct. Mem. 1189 (1945).

[43]335 U.S. 632 (1949).

[44]*Id.* at 645.

the income beneficiaries. Control of the corporation was retained by the decedent in the form of the voting rights. The capital investment could not be enjoyed by the income beneficiaries through the sale or use of the stock as collateral because the decedent had power over any disposition of the trust assets. Income beneficiaries can only benefit from the increase in capital growth if the growth yields a higher rate of income. Since the stock in trust had a very low income yield, the only way the income beneficairies could benefit would be for the trustee to sell the stock and reinvest the corpus and the capital gain in other income-producing property. The trustee was prevented from doing this by the restrictions imposed by Byrum. The only benefit Byrum gave up was the income which, for all practical purposes, was nonexistent.[45]

The majority failed to find a "substantial economic benefit" in the powers retained by the decedent. Certainly it could not be said that the income beneficiaries received a benefit as a result of their almost nonexistent dividend income.[46] The failure to find a "substantial present economic benefit" in Byrum's control over the trust property did not give a true picture of corporate affairs,[47] nor is it supported by Byrum's own conduct in retaining control of the stock. The decedent must have considered control of the corporation valuable in that he not only guaranteed his voting control, but also restricted any possible disposition of the stock that would affect that control.[48] The essence of the problem is aptly summarized by the dissent: "[T]he majority's discourse on § 2036(a)(1) is an unconvincing rationalization for allowing Byrum the tax free 'enjoyment' of the control privilege he retained through the voting power of the shares he supposedly 'absolutely' and 'unequivocally' gave up."[49]

The majority's narrow construction of section 2036(a)(2) in construing "right" to mean a "legally enforceable power"[50] to avoid the reach of section 2036(a)(2) is erroneous in two major respects. When the

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[45]The trust received $339 in dividends in the five years of its existence before the death of the decedent. In the sixth year, the year of the decedent's death, $1,498 in dividends were paid to the trust. 92 S. Ct. at 2398.

[46]*Id.*

[47]*See* N. LATTIN, THE LAW OF CORPORATIONS § 87, at 343 (2d ed. 1971). A stockholder does in fact receive substantial benefits through his control of the corporation. The power inherent in his position allows him the enjoyment of a great deal of influence over the corporation and the minority stockholders.

[48]92 S. Ct. at 2400 (White, J., dissenting).

[49]*Id.*

[50]*Id.* at 2390 states: "The term 'right,' certainly when used in a tax statute, must be given its normal and customary meaning. It connotes an ascertainable and legally enforceable power. . . ."

majority interprets "right" as a legally enforceable right, it is using the statute to tax the decedent based on rigid, formal control rather than on the realities of the situation. This is contrary to legislative intent as evidenced by the passage of the Joint Resolution of March 3, 1931.[51] The *Byrum* decision is an unfortunate return to the *May v. Heiner*[52] rationale. Contrary to the opinion of the majority, *United States v. O'Malley*[53] cannot be used to reach this interpretation of right as connoting a "legally enforceable right" because the *O'Malley* decision was more concerned with realities than with legal technicalities.[54] The *O'Malley* Court never was concerned with the problem since the power was enforceable. In addition, the *Byrum* Court in its interpretation of section 2036(a)(2) ignores the interpretation given "right" in section 2036(a)(1) by other courts which have refused to narrow the meaning of the statute.[55] One court faced with a "right" to receive the income from a trust that was barred by the Statute of Frauds held the trust includible despite the unenforceable nature of the right.[56] Clearly the interpretation of the word "right" by the Court is not the normal and customary meaning as used by other courts.

Once the restriction imposed by "legally enforceable right" is removed, the issue should become whether the decedent could have desig-

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[51]The current § 2036 was enacted in part by the Joint Resolution of March 3, 1931, Pub. L. No. 131, ch. 454, 46 Stat. 1516, which passed through both houses in one day due to the emergency situation created by the decision in May v. Heiner, 281 U.S. 238 (1930), and two per curiam decisions that followed shortly thereafter. *May* allowed a decedent to create a life estate in his property without inclusion in his gross estate on the grounds that the property had already been given to the remainderman prior to the death of the decedent. If allowed to stand, the *May* loophole would have effectively crippled the federal estate tax. Congress clearly indicated its rejection of such a result and attempted to revise the statute to include transactions which the objective intention or result was in fact a testamentary disposition. The action by the *Byrum* Court is clearly a step away from this objective.

[52]281 U.S. 238 (1930). The *May* decedent created a trust under which the income was payable to the decedent's husband for his life and upon his death payable to the decedent. The remainder was to be distributed equally among her children upon her death. The assets of the trust were held not includible since the transfer did not take effect in possession or enjoyment at or after her death. The *May* Court relied on property law and looked at the form of the transaction as a present transfer of future rights, an approach clearly rejected by Congress as evidenced by the immediate passage of the Joint Resolution of March 3, 1931, Pub. L. No. 131, ch. 454, 46 Stat. 1516.

[53]383 U.S. 627 (1966).

[54]92 S. Ct. at 2403 (White, J., dissenting).

[55]*See, e.g.*, Skinner v. United States, 316 F.2d 517 (3d Cir. 1963). The *Skinner* settlor retained no "legally enforceable right" under the trust instrument as did O'Malley, but the trust was held includible nonetheless.

[56]McNichol v. Commissioner, 265 F.2d 667 (3d Cir.), *cert. denied*, 361 U.S. 829 (1959) (an oral agreement to receive the income from the property transferred).

nated between the income beneficiary and the remainderman.[57] The majority felt that he had such a right, but its use was sufficiently restricted by an "external standard"[58] which, under the teachings of *Jennings v. Smith*,[59] would keep the trust assets out of his gross estate. The Court compared the powers of the trustee and the powers of the majority stockholder and then applied the "external standard" concept to the latter. There is grave doubt, however, whether any "external standards" exist that can be applied to the conduct of the corporate board.[60] Courts have been hesitant to interfere with the management and business decisions of the directors of a corporation;[61] therefore the threat of a derivative suit may not in fact supply the necessary "external standard" as supposed by the majority. Additionally, this "external standard" on which the Court heavily relies to justify non-inclusion is not a standard created by the trust instrument. One court, although referring to a trustee situation, stated that an external standard cannot be implied from extrinsic circumstances not contained in the trust agreement.[62] In addition, a settlor who arranges his affairs properly can not only avoid suit by the minority shareholders, but also can avoid the imposition of the accumulated earnings tax on his corporations.[63] The duty owed to minority shareholders by the majority shareholders as alleged by the majority appears to have some support.[64] However, even if such a duty could be found it could only be exercised through Byrum's power to vote for the board of directors, but in the opinion of the *Byrum* Court a majority stockholder can exercise no control over the corporate board since the board is subject to other "external controls."[65] It would appear that the Court's extension of the "external standard" concept of

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[57]*See* note 2 *supra*.

[58]Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947). "External standard" is a term of art used to describe conditions set out in the trust agreement or in the case law of the state which a court of equity can rely on in deciding if the trustee has gone beyond the scope of his powers or has abused his discretion. If an "external standard" exists then a trustee's actions are subject to review and the income beneficiary and the remainderman are protected from the mistakes or wrongful acts of the trustee.

[59]*Id.* Section 2036(a)(2) does not cover "powers to designate" which are non-discretionary in nature. If the powers retained by the settlor are controlled by a determinable "external standard" enforceable by a court having equity jurisdiction, then they are non-discretionary. *See, e.g.*, Industrial Trust Co. v. Commissioner, 165 F.2d 142 (1st Cir. 1947).

[60]Murray, *supra* note 40, at 17; Soled, *supra* note 31, at 217.

[61]*See, e.g.*, Murray, *supra* note 40, at 17.

[62]Biscoe v. United States, 148 F. Supp. 224 (D. Mass. 1957).

[63]92 S. Ct. at 2402 (White, J., dissenting).

[64]H. HENN, *supra* note 29, § 240.

[65]92 S. Ct. at 2391-93.

the trust to include the fiduciary duty of majority stockholders and directors of the corporation to minority stockholders is not justified by the realities of corporate life.[66]

The majority of the Court used the principle of "reliance" as another justification for allowing Byrum to escape taxation on the trust assets. The "principle of legitimate reliance" on clearly established case law may be sound elsewhere, but not in this area of the law. The amount of power which could be retained safely without invoking section 2036 was far from established.[67] By allowing the decedent or his counsel to interpret the case law as they see it and to use it as a defense to inclusion is wholly irrational. This application will result in havoc for the courts in attempting to apply the tax statutes.

The *Byrum* dissent very aptly showed that the majority's opinion does not withstand close analysis. The Court appears to be reverting to the pre-*May v. Heiner*[68] era of a narrow and formal interpretation of the statute. The court hints at its motivation for such a step in a footnote to their opinion:

> The interpretation given § 2036(a) by the Government and by Mr. Justice WHITE'S dissenting opinion would seriously disadvantage settlors in a control posture. If the settlor remained a controlling stockholder, any transfer of stock would be taxable to the estate. . . . The typical closely held corporation is small, has a checkered earning record and has no market for its shares. Yet its shares often have substantial asset value. To prevent the crippling liquidity problem that would result from the imposition of estate taxes on such shares, the controlling shareholder's estate planning often includes an irrevocable trust. The Government and the dissenting opinion would deny to controlling shareholders the privilege of using this generally acceptable method of estate planning without adverse tax consequences. Yet a settlor whose wealth consisted of listed securities of Corporations he did not control would be permitted the tax advantage of the irrevocable trust even though his more marketable assets present a far less serious liquidity problem. The language of the statute does not support such

[66] *See* R. BAKER & W. CARY, CASES AND MATERIALS ON CORPORATIONS 403-617 (3d ed. 1959); N. LATTIN, *supra* note 47, § 78; Murray, *supra* note 40; Soled, *supra* note 31.

[67] 92 S. Ct. at 2403-04 (White, J., dissenting); Gray & Covey, *State Street—A Case Study of Sections 2036(a)(2) and 2038*, 15 TAX L. REV. 75 (1959).

[68] 281 U.S. 238 (1930). *May v. Heiner* was the last major case under § 2036 to use the principles of property law in defining testamentary dispositions. Congress intervened with the Joint Resolution of March 3, 1931, indicating that Congress did not intend for property law to control the estate tax law. *See, e.g.*, United States v. Estate of Church, 335 U.S. 632 (1949).

> a result and we cannot believe Congress intended it to have such discriminatory and far-reaching impact.[69]

The Court appears to fear the possibility of inequality in the application of the statute to stockholders in a control posture. This fear is ill-founded, as shown by the recent decision of *Estate of Harry H. Beckwith*,[70] which allowed the decedent to maintain control of voting rights in stock he held at his death without inclusion in his gross estate because he had no other power as to disposition and investment. This result certainly does not put the settlor at a disadvantage. In addition, a settlor should not be allowed to keep substantial control on property he transfers by gift. If he is not willing to transfer the property without strings attached, then he should not be entitled to the benefit of escaping estate taxation on such property. A settlor is not allowed to maintain strings on other types of property; why then should an exception be made in the case of a closely held corporation?

The full impact of *Byrum* is not clear. The scope of *Byrum* appears to include settlors with one hundred percent stock ownership as well as majority stockholders. By transferring all or a part of his stock into trust with a third party as trustee, a settlor apparently may retain the *Byrum* powers without fear of estate taxation. The transfer to a third party trustee would create the necessary minority stockholder to whom the board of directors would owe a fiduciary duty. The settlor could accomplish this result with very little, if any, loss of control of the stock. In addition, the interpretation of the statute to include only a "legally enforceable power"[71] opens up another door to the tax planner. Conceivably, a settlor might now be able to place property in trust and retain a life estate through an oral agreement, which would be void under the Statute of Frauds. Since the oral agreement would not be "legally enforceable," the trust assets would not be included in the gross estate. Members of the settlor's family might be willing to honor the agreement despite its unenforceability. As can be seen, *Byrum* opens up a whole new area in which the prudent tax planner may avoid substantial estate taxes for his client of which the above examples are just a couple of

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[69]92 S. Ct. at 2397 n.34.

[70]55 T.C. 242 (1970). Beckwith transferred stock of a closely held corporation to a trust. He retained voting control over that stock through the annual execution of proxies by the trustee. The court could find no expressed or implied agreement with respect to the trust that would restrict the trustee from either voting the stock himself or of disposing of it. It held the stock was not includible in the decedent's gross estate.

[71]*See* note 50 *supra*.

many possible avoidance schemes. The full impact may not be perfectly clear until the lower courts begin to apply *Byrum*, but apparently *Byrum* has created a substantial loophole in the estate tax field.

The *Byrum* decision creates a gross inequity in favor of a settlor with substantial stock interest. It gives him control benefits that a settlor with land or other types of property interests would not dream of retaining without fear of estate taxation. The Court has also gutted a major portion of section 2036 with its interpretation of "right," which has severely limited the scope of this section. However, the tax loophole created gives Congress a compelling opportunity finally to clarify its intention as to the scope of section 2036 after so many years of court indecision and confusion.[72] If Congress accepts this opportunity, the tax planner might finally be able to advise his client with some assurance as to the effect of his transfer.

WILLIAM L. TANKERSLEY III

Labor Law—The Obligations of a Successor Employer.

"In taking over a going concern or labor force, the labor title is to be searched as diligently as the title to real property."[1] A number of labor disputes have arisen from uncertainty as to the obligations owed by the acquiring company to the predecessor's union following the merger with or acquisition of a unionized business. The recent Supreme Court decision in *NLRB v. Burns International Security Services, Inc.*[2] should dispel some of the confusion stemming from prior court and National Labor Relations Board attempts to interpret the mandates of the Labor Management Relations Act[3] (the Act) in regard to the labor obligations of the successor employer.[4]

Imposition of successorship status upon the acquiring corporation

[72]Convey, *Section 2036—The New Problem Child of the Federal Estate Tax*, 4 TAX COUNSEL Q. 121 (1960).

[1]Sangerman, *The Labor Obligations of the Successor to a Unionized Business*, 19 LAB. L.J. 160 (1968), *quoting* City Packing Corp. (1948) (no further citation given; probably an unpublished arbitration decision).

[2]92 S. Ct. 1571 (1972).

[3]Labor Management Relations Act (Taft-Hartley Act), 29 U.S.C. §§ 141-188 (1970).

[4]John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543 (1964), in which the Court reserved decision on the question of survival of the previously negotiated collective bargaining agreement, was used as the rationale for the Board's mistaken conclusion that the entire collective bargaining agreement survived the change in ownership. The Board's order in the *Burns* case was a result of its interpretation of the meaning of *Wiley*.

enables the Board, or the Federal Courts as enforcers of the Board's orders, to place certain obligations on the successor that would not be required of a non-successor. The purpose of imposing these obligations is to protect the predecessor's employees from the potentially harsh effects of a change in ownership over which they have no control.[5]

Uncertainty over the obligations of a successor employer has been due in part to the fact that the law of successorship is not governed simply by the principles of contract and corporate law.[6] A collective bargaining agreement is more than an ordinary contract as the Board and the Supreme Court have established.[7] The status accorded to the collective bargaining agreement has been used to justifying binding a non-consenting successor employer to some of the obligations of a pre-existing agreement in accordance with the "national labor policy" of balancing the rights of employers to freely operate their businesses with the desire to protect the employees from a "sudden change in the employment relationship."[8]

Burns was low bidder for a contract to provide security service at a Lockheed facility previously served by Wackenhut Corp., a competitor of Burns. Prior to the expiration of the contract between Wackenhut and Lockheed, Wackenhut had entered into a collective bargaining agreement with the United Plant Guards (UPG), a union which had been certified as the exclusive bargaining agent of the Wackenhut employees after a Board-held election.

When Burns began providing services at the site, it did so with knowledge of the previously existing agreement but without implicitly or explicitly assuming any of Wackenhut's contractual obligations and without obtaining any of Wackenhut's assets, physical or otherwise. There was absolutely no privity of contract or other economic relationship between the two companies and no evidence upon which Burns could be held to have assumed the collective bargaining agreement which bound Wackenhut and UPG.[9] Burns did, however, hire twenty-seven former employees of Wackenhut and brought in fifteen of its own employees from other sites in forming its labor force at Lockheed.

Although Burns knew of the certification of UPG, it refused to bargain with the union, and the UPG filed an unfair labor practice

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[5]John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 548 (1964).

[6]Sangerman, *supra* note 1.

[7]John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 550 (1964); United Steelworkers v. Warrior & Gulf Navig. Co., 363 U.S. 574, 578 (1960).

[8]John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 549 (1964).

[9]92 S. Ct. at 1575.

charge against Burns for refusing to bargain.[10] The trial examiner found Burns guilty of refusing to bargain.[11] The Board, in affirming, relied on its interpretation of the Supreme Court's decision in *John Wiley & Sons v. Livingston*[12] in holding that Burns was bound both to bargain with the union and to honor the substantive terms of the previously existing agreement between Wackenhut and UPG.[13]

The Supreme Court in a five-four decision agreed that Burns was obligated to bargain with UPG because Burns had "voluntarily [taken] over a bargaining unit that was largely intact and that had been certified within the past year."[14] However, the Court unanimously reversed the Board's order obligating Burns to the prior collective bargaining agreement.[15] The Court limited its earlier holding in *Wiley* in such a way as to invalidate the implications which had been drawn from that decision by the Board and by at least one lower court.[16]

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[10]The unfair labor practice charges alleged violations of the Labor Management Relations Act (Taft-Hartley Act), §§ 8(a)(5), (1), 29 U.S.C. §§ 158(a)(5), (1) (1970), which make it an unfair labor practice for the employer to refuse to bargain collectively with the certified union. Additionally, the Board held that Burns had violated §§ 158(a)(2), (1) of the same Act by unlawfully recognizing and assisting a rival union during the time in which it refused to bargain with UPG. This finding was not challenged on appeal by Burns and was not part of the issue reviewed by the Supreme Court. 92 S. Ct. at 1576.

[11]92 S. Ct. at 1576.

[12]376 U.S. 543 (1964).

[13]William J. Burns Int'l Detective Agency, Inc., 182 N.L.R.B. 348, 349 (1970). On appeal to the Second Circuit, William J. Burns Int'l Detective Agency, Inc., v. NLRB, 441 F.2d 911 (2d Cir. 1971), Burns challenged the finding of successorship and the order requiring it to honor the prior agreement to which it was not a party. Burns also challenged the finding that the Lockheed job site constituted an appropriate unit for collective bargaining purposes. Burns attempted to show that its previous policy had been to deal with larger employee units due to its frequent shifting of employees from site to site. Both the court of appeals and the Board found the Lockheed site to be an appropriate unit and the Supreme Court did not consider this issue due to the limited grant of certiorari. 92 S. Ct. at 1577.

[14]*Id.* at 1582.

[15]*Id.* The Court drew part of its interpretation of the policy embodied in the Act from H.K. Porter Co. v. NLRB, 397 U.S. 99 (1970), which did not deal with successorship but with the power of the Board to force a certain provision upon an employer as a remedy for an unfair labor practice. The *Burns* Court held that:

> "[A]llowing the Board to compel agreement when the parties themselves are unable to agree would violate the fundamental premise on which the Act is based—private bargaining under governmental supervision of the procedure alone. . . ."
>
> . . . The congressional policy manifest in the Act is to enable the parties to negotiate for any protection either deems appropriate, but to allow the balance of bargaining advantage to be set by economic power realities. Strife is bound to occur if the concessions . . . do not correspond to the relative strength of the parties.

92 S. Ct. at 1582. *See also* NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 45 (1937).

[16]*See* Wackenhut Corp. v. Int'l Union of Plant Guards, 332 F.2d 954 (1964), in which the Ninth Circuit held that *Wiley* could be construed as authority for holding that the successor

In limiting *Wiley*, the Court pointed to the different procedural contexts of the cases. *Wiley* arose from a suit under section 301 of the Labor Management Relations Act[17] to compel arbitration, and *Burns* arose from an unfair labor practice charge where the Board's power to grant relief is limited by section 8(d) of the Act.[18] Further, *Wiley* could have been decided on the basis of a state corporate merger law[19] that imposed the obligations of the disappearing corporation on the surviving corporation.

In *Wiley*, a smaller, unionized company was merged with a larger, non-unionized corporation. The union brought a section 301 suit to compel arbitration as to whether certain provisions of the prior agreement had survived the change in ownership because contractural disputes were subject to arbitration. The Supreme Court, without deciding that successor employers are bound by the pre-existing agreement, held that the surviving corporation was under a duty to arbitrate since the merits of the dispute were subject to arbitration under the prior agreement.[20]

The Board subsequently interpreted *Wiley* as holding that the entire collective bargaining agreement had survived the change in ownership.[21] The General Counsel then authorized the issuance of several section 8(a)(5)[22] complaints on the grounds that various successor employers had refused to recognize the pre-existing collective bargaining agreement.[23] *Burns* was a result.

The *Burns* Court emphatically disagreed with the Board's analysis of *Wiley*, holding that "*Wiley* suggests no such open-ended obligation. Its narrower holding dealt with a merger occurring against a background of state law which embodied the general rule that in merger situations the surviving corporation is liable for the obligations of the disappearing corporation."[24] The Court did, however, recognize that the

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employer is bound to the prior collective bargaining agreement.

[17]29 U.S.C. § 301 (1970).

[18]29 U.S.C. § 158(d) (1970), which limits the Board's role in bargaining disputes to that of supervising the procedure of collective bargaining without giving it authority to impose terms on either party.

[19]*See* N.Y. STOCK CORP. LAW § 90 (McKinney 1951); W. FLETCHER, PRIVATE CORPORATIONS § 7121 (rev. ed. 1961).

[20]376 U.S. at 549, 550.

[21]92 S. Ct. at 1581.

[22]29 U.S.C. § 158(a)(5) (1970).

[23]Gordon, *Legal Questions of Successorship*, 3 GA. L. REV. 280, 308 (1969), *citing* NLRB, *Report on Case Handling Developments*, 58 L.R.R.M. 54, 57-58 (1965).

[24]92 S. Ct. at 1581.

actions of a successor in insuring that a favorable collective bargaining agreement would survive the acquisition might create, as a matter of factual inference, an implied obligation to honor such an agreement.[25]

Although the Court unanimously condemned the imposition of a duty to honor an agreement not assented to, no consensus was reached on the question of when successorship should be applied. A strong dissent by four Justices disagreed even with the finding that Burns was a successor.[26]

> [Imposition of successorship] cannot logically be extended to a mere naked shifting of a group of employees from one employer to another without totally disregarding the basis for the doctrine. The notion of a change in the "ownership or structure" of an enterprise connotes at the very least that there is continuity in the enterprise, as well as change; and that that continuity be at least in part on the employer's side of the equation, rather than only on that of the employees.[27]

The dissenters would impose successorship only when the alleged successor had "succeeded to some of the tangible or intangible assets by the use of which the employees might have expected the first employer to have performed his contract with them,"[28] analogizing the rights of employees to those accorded claimants who are protected from loss due to a transfer of assets by the entity in which they have a claim.[29]

Burns clearly affects the doctrine of successorship in three primary ways. First, the duty to honor a predecessor's collective bargaining agreement does not attach unless there is a voluntary or implied assumption of the agreement by the successor or unless the transfer of ownership was made in bad faith to an alter ego company to escape existing obligations. Secondly, the imposition of a duty to arbitrate the extent to which the provisions of a pre-existing agreement survive a merger or wholesale transfer of assets would appear to be limited to situations conforming closely to *Wiley*. Thirdly, the future imposition of successorship may well be influenced by some change in the perspective from which continuity of the operation is judged.[30]

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[25] *Id.* at 1584.

[26] *Id.* at 1586 (Rehnquist, J., dissenting).

[27] *Id.* at 1590-91 (Rehnquist, J., dissenting).

[28] *Id.* at 1591 (Rehnquist, J., dissenting).

[29] *Id.*

[30] *Burns* also dealt with the duty of a successor not to change unilaterally the existing terms of a collective bargaining agreement. The Court held that Burns was not guilty of such a violation because it was not bound by the Wackenhut-UPG agreement and thus could not be guilty of changing terms when none existed. *Id.* at 1585. The Court indicated that a successor employer

The *Burns* Court is justified in its unanimous disapproval of binding the successor to the entire collective bargaining agreement of its predecessor. Not only is the *Burns* result apparently compelled by interpretation of the Act,[31] but the realities of commercial life dictate such an approach.[32] To bind the successor to the prior agreement to which he has not assented would restrict his opportunity to freely conduct his business; indeed, the acquisition of any unionized business would become unattractive if such a rule were established, since the successor would lose the power to determine one of his main operating factors, the cost and conditions of his labor.

It is true that in many cases the existence of a collective bargaining agreement embodying a favorable labor arrangement is a prime consideration in the decision to acquire a going concern.[33] It is also true that the predecessor's employees deserve protection from a change in ownership. However, to bind the successor to the prior agreement would promote the kind of rigidity that restricts rather than encourages the free flow of capital and the private ordering of labor agreements based on economic realities. In many cases such an imposition would deprive the union of an opportunity to seek even greater benefits from the successor who is often more prosperous than the previous owner.[34] The best solution would appear to be one in which survival of the agreement is determined by the mutual assent of the successor and the union rather than solely by the successor employer or the Board.[35] Consequently, it

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would be generally free to specify the initial basis on which it intends to hire and that the bargaining obligation—and thus the duty not to unilaterally change terms and conditions of employment—would arise only when the successor should know that the majority of his labor force are the unionized employees formerly employed by the predecessor. *Id.* at 1586.

[31]*See* note 14 *supra.*

[32]*See* Emerald Maintenance, Inc., 188 N.L.R.B. No. 139 (1971), in which the Board, after its ruling in *Burns*, refused to bind a successor to the prior labor agreement because of an existing policy of annual rebidding which produced yearly changes in contractual identity. Thus, to hold the successor bound to the agreement would be to greatly circumscribe his ability to meet the yearly changes in such a business situation. The *Burns* Court pointed to other dangers of binding the successor, such as potential responsibility for past obligations owing under the agreement and the fact that the successor might well have to consider the predecessor's employees as his own and thus not be able to replace them with his own employees, although his motivation might be legal under any interpretation of the Act. 92 S. Ct. at 1582-83. *See id.* at 1592 (Rehnquist, J., dissenting); Rohlik, Inc., 145 N.L.R.B. 1236 (1964); and General Extrusion Co., 121 N.L.R.B. 1165 (1958), for circumstances in which the Board refused to bind a successor to his predecessor's labor agreement.

[33]92 S. Ct. at 1584. By implication, an agreement that is favorable enough to honor can also be construed as favorably influencing a decision to acquire in that the same attractive factors are weighed in each circumstance.

[34]*Id.* at 1582.

[35]Gordon, *supra* note 23.

would seem wise to include the union in negotiations leading to the change in ownership.

Imposition of a duty to arbitrate upon the successor raises other problems. *Burns* holds that the agreement does not survive a change in ownership absent assumption in fact or in law by the successor, but without a bargaining agreement, what is left to arbitrate? *Wiley* now presents the paradoxical situation of a duty arising from the prior agreement, although the prior agreement does not survive. *Burns* thus limits the situations in which arbitration is even a possibility.[36]

There are far fewer theoretical problems raised by *Burns* holding that the successor has a duty to bargain with the predecessor's union when his labor force contains as a majority former employees of the predecessor. Clearly, the preference of the employees concerning their bargaining representative should be honored under the Act,[37] which requires employers to avoid coercive activity which would tend to restrict the free exercise of the employees' right to organize and to be recognized.[38] The duty to bargain, then, is but a theoretical extension of the rights accorded employees by the Act:

> The duty of an employer who has taken over an 'employing industry' to honor the employees' choice of a bargaining agent is not one that derives from a private contract, nor is it one that necessarily turns upon the acquisition of assets or assumption of other obligations usually incident to a sale, lease, or other arrangement between employers. It is a public obligation arising by operation of the Act.[39]

Burns clearly does nothing to change the status of this potential obligation but is significant as an analysis of the threshold question whether successorship and the duty to bargain should be imposed.

The Board has relied on factors relating to the degree of continuity across the change in ownership in the "employing industry"[40] while the Court has enunciated a test of whether substantial continuity of identity

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[36]The decision in *Burns* casts doubt that any analysis can henceforth be used to justify an imposition of a duty based upon the survival, disguised as it may be, of the previous bargaining agreement. Should such a decision be reached, however, the flexible approach set forth in United Steelworkers v. Reliance Universal, Inc., 335 F.2d 891 (3d Cir. 1964), which requires the arbitrator to "remake" the agreement considering any changed circumstances due to the transfer of ownership, is more in line with the *Burns* approach to successorship.

[37]*See* Labor Management Relations Act (Taft-Hartley Act) § 7, 29 U.S.C. § 157 (1970).

[38]Labor Management Relations Act (Taft-Hartley Act) § 8(a)(1), 29 U.S.C. § 158(a)(1) (1970).

[39]Maintenance, Inc., 148 N.L.R.B. 1299, 1301 (1964).

[40]NLRB v. Auto Ventshade, Inc., 276 F.2d 303, 304 (5th Cir. 1960).

in the enterprise exists before and after the change.[41] Both tests examine factors such as the following: whether the predecessor's work force is retained, whether the same plant is used, whether the product or service is similar, whether supervisory personnel are retained, whether the same methods of operation are continued, and even whether the product name remains the same.[42] The status and size difference between the predecessor and the successor can also be important: where the size difference is great and the successor is himself unionized, there is a possibility that the predecessor's employees may be held to have been "accreted"[43] into the union of the larger successor.

The decision in *Burns* serves to emphasize the weight accorded to retention by the successor of a predecessor's work force or enough of it so that a majority of the successor's labor force is made up of the predecessor's employees. The duty to bargain that arises from such circumstances seems entirely in line with the theory that the doctrine of successorship generally is a means of protecting the benefits won by the employees' union from a change in ownership.[44] It seems that the legitimate expectation of the workers employed by the successor would be that their elected and certified representatives would continue to be their agents in dealings with management, especially when the tasks to be performed are substantially the same, as they were in *Burns*.

Admittedly, the majority would justify a finding of successorship in situations in which the continuity is solely on the employees' side of the equation, for this was the situation in *Burns*. The dissent would prohibit imposition of successorship unless continuity were found to exist on both sides. The dissent said that to do more would be to exceed the employees' legitimate expectations at the expense of the successor who has not succeeded to any of the assets by the use of which the predecessor would have honored those expectations.[45]

This perspective-of-continuity analysis raises certain questions. First, in view of the purpose of the doctrine of successorship to mitigate the potentially harsh effects of a change in ownership, should continuity (or privity) between employers be a consideration at all as long as the tasks performed remain essentially the same? Secondly, if such continu-

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[41]John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 551 (1964).

[42]Gordon, *supra* note 23, at 284; Sangerman, *supra* note 1, at 163.

[43]"Accretion" is the effective integration of the predecessor's employees into the bargaining unit of the successor employer. For an example of a successorship case involving accretion and the duty to bargain, *see* McGuire v. Humble Oil & Ref. Co., 355 F.2d 352 (2d Cir. 1966).

[44]John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543 (1964).

[45]92 S. Ct. at 1591 (Rehnquist, J., dissenting).

ity or privity becomes a requirement, could this not be supplied by looking at the labor forces' trained presence as an intangible asset the existence of which often positively influences the competitor to enter his bid?

Certainly, there is ample support for the proposition that labor force composition has and should continue to be the chief factor evaluated in deciding close questions of successorship.[46] Analysis of the grounds of decision in *Burns*, of Board decisions over a recent twenty year span,[47] and a holding of the Seventh Circuit[48] indicates that while work force retention is often spoken of as evidence of requisite continuity, it may well be determinative in close cases in which other factors point to differing results.

The effect of work force retention upon the ultimate decision in successorship cases can be lessened by circumstances which alter the context in which the successor will operate, such as the temporary nature of the enterprise,[49] or where the successor evidences a totally different concept of operation.[50] Clearly however, *Burns* does nothing to modify the existing illegality of discriminatory non-hiring of a predecessor's unionized employees. Should the successor decline to hire former employees due to their union membership, he is still subject to an order to bargain as well as an unfair labor practice charge.[51]

Burns would appear to be more significant as a limiting of *Wiley* and as a sensible approach to the balancing of employee protection with free bargaining than as an enlightening new approach to the threshold issue of whether successorship should be found. Elimination of the possibility of binding a successor to the pre-existing labor agreement which the Board had interpreted to be within its power after *Wiley* is sound in view of the policy of the Act and in light of the other obligations

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[46]*See* Goldberg, *The Labor Law Obligations of a Successor Employer*, 63 NW. U.L. REV. 735 (1969); Gordon, *supra* note 23.

[47]*See* Goldberg, *supra* note 46, at 794, in which the author reported that in a twenty year period from 1949 to 1969 the Board found successorship fifty-one times out of fifty-nine possibilities when the successor had a work force composed of a majority of the predecessor's employees and found successorship only twice (with one of these cases being reversed on appeal and later cited with approval by the Board) when the alleged successor did not employ as a majority of his work force employees of the predecessor.

[48]Tom-A-Hawk Transit, Inc. v. NLRB, 419 F.2d 1025 (7th Cir. 1969), a case involving almost the same factual situation as *Burns*—successorship being found although there were no contractual ties between the two companys on the basis of common labor force.

[49]Northwest Galvanizing Co., 168 N.L.R.B. 26 (1967).

[50]Retail Clerks Local 954 v. Lane's of Findlay, Inc., 260 F. Supp. 655 (N.D. Ohio 1966).

[51]K.B. & J. Young's Super Mkts., Inc. v. NLRB, 377 F.2d 463 (9th Cir. 1967).

vesting in the successor which adequately protect the unionized employee. In many cases the successor will choose to assume the prior collective bargaining agreement as a means of avoiding turmoil and to insure that a favorable labor contract will continue.[52] In other cases in which this is not done, imposition of a duty to bargain seems a more equitable method of assuring that present economic realities are the basis of the provisions of the collective bargaining agreement than requiring the successor to honor an agreement to which he was not a party. Industrial peace would be harshly achieved at the price of governmental ordering of both the procedure and substance of labor agreements.

The corporation contemplating acquisition of or merger with a unionized company would be well advised to resolve all issues relating to the former labor agreement before closing the transaction. The potential successor would do well, also, to include the union in the pre-transfer negotiations should the union evidence an intention to try to bind the successor to the pre-existing collective bargaining agreement. Every reasonable attempt should be made to recognize and deal fairly with the predecessor's union lest the transitional period between owners lead to strikes and unfair labor practice charges brought before the Board.

LUTHER PARKS COCHRANE

Property Law—The North Carolina Association of Realtors' Contract of Sale

The North Carolina Association of Realtors' standard form contract of sale[1] or similar forms specify the legal rights and obligations of most buyers and sellers of real estate in North Carolina. In a typical transaction, a broker, as the agent of the seller, arranges the sale. When a buyer decides to purchase, he ordinarily signs the form contract provided by the broker. Very few buyers or sellers in North Carolina see an attorney before they have signed the contract of sale.[2] Because of this

[52]92 S. Ct. at 1584.

[1]North Carolina Association of Realtors' Contract of Sale, standard form No. 8 (rev. 1967). The contract is reprinted as an appendix to this note.

[2]Given the importance of such a transaction, it is curious that parties usually do not seek legal advice. This has been explained as a lack of legal sophistication of the public or a fear of onerous legal fees. However, the fees for drafting or explaining a contract would probably be less than the

fact real estate brokers should use a form contract which is fair to both buyer and seller, which provides the full legal protection the parties need, and which reflects the bargain the individual buyer and seller desire. The Association's contract provides inadequate legal protection in several areas, including the transfer of fixtures and personal property, marketable title exceptions, liens and assessments, form of deed and tenancy, remedies upon default or termination of the contract and warning to the parties of their need for an attorney.

Fixtures and Personal Property

A major problem in the Association's contract is failure to provide for transfer of fixtures and personal property. Title to personal property is a frequent area of dispute between buyer and seller. For example, although the buyer may consider draperies and wall-to-wall carpeting to be part of the sale, the seller may plan to take the draperies and carpeting with him when he moves. The law of fixtures governs the rights of the parties in such circumstances. A fixture is personal property so connected or attached to the realty as to be considered a part thereof.[3] Fixtures are normally treated as realty and are transferred to the purchaser along with the real property.[4] Because fixtures are transferred along with the real estate, the need for special treatment in a real estate contract is seemingly eliminated. However, North Carolina law provides no easy definition of fixtures. Whether personal property becomes a fixture depends on whether, at the time it was attached to the real estate, the person who attached it intended a permanent annexation. Factors which must be weighed to determine this intent include the objectively manifested intent of the annexor, the character of the annexation, the permanency of the annexor's estate, and the nature and purpose of the annexation.[5] Whether a chattel is a fixture under North Carolina law may, therefore, be impossible to decide without a court

public anticipates especially if the services are provided in conjunction with the title search. Brokers are often hesitant to encourage clients to see an attorney. They may fear that the attorney will draft a biased contract which the other party would not sign and that ill feeling would cause the entire transaction to fall. Regrettably, some brokers use high pressure sales tactics and want the buyer to sign the form contract immediately to prevent him from changing his mind. *See* Whitman, *Transferring North Carolina Real Estate Part I: How the Present System Functions*, 49 N.C.L. REV. 413, 423 (1971).

[3] 5 AMERICAN LAW OF PROPERTY § 19.1, at 4 (A. Casner ed. 1952) [hereinafter cited as A. CASNER].

[4] *Id.* § 19.6, at 26.

[5] J. WEBSTER, REAL ESTATE LAW IN NORTH CAROLINA §§ 11-17 (1971) [hereinafter cited as J. WEBSTER].

decree on the subject. No definitional assistance is provided by the Uniform Commercial Code, which leaves the definition of fixtures to state law.[6]

The best method to avoid the problem of ownership of personalty is to provide a contractual solution. The contract of the North Carolina Association of Realtors, however, does not cover the transfer of personalty and leaves the parties to the inadequacies of fixtures law. Many form contracts either list all personalty to be conveyed or leave a blank space in which the buyer must list the personalty to be conveyed.[7] In order to avoid placing the burden of listing personalty entirely on the buyer and to provide flexibility for all possible contingencies, it might be well (1) to list in the printed contract, items commonly considered to be fixtures as property to be transferred (which the seller can delete if he so desires),[8] (2) to allow blank space for the buyer to specify any additional personal property he considers to be part of the sale, and (3) to provide space for the seller to specify property potentially classifiable as fixtures which he intends to keep.

Liens and Assessments

Another inadequacy of the Association of Realtors' contract is the failure to provide for the contingency of liens and assessments on the property. Disputes between buyer and seller arise over which party should bear the responsibility for paying liens against the property for such improvements as aluminum siding, sidewalks, and sewers. A lien is a "right conferred on certain classes of creditors to have their debts paid out of specific property belonging to the debtor."[9] Under the common law, unless the contract of sale specifies otherwise, the seller must pay all assessments due and unpaid while the contract is executory.[10] However, liens arising prior to closing, but not yet assessed or payable,

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[6]N.C. GEN. STAT. § 25-9-313(1) (1965); WEBSTER § 22.

[7]This information was obtained by examining several form contracts of sale including, for example, the Evanston-North Shore Board of Realtors' form 7-52, Offer to Purchase Real Estate with Mortgage Contingency, and the Pioneer Title Insurance Co.'s form, Agreement for Sale of Real Estate (1967).

[8]For example, the contract might provide as follows: "Built-in heating and cooling equipment, built-in kitchen appliances including range, refrigerator, sink and _____, kitchen and bathroom cabinets, shutters, venetian blinds, shades, curtains, wall-to-wall carpeting, mirrors, garden tools, shrubbery and _____ shall be included in the sale." *See generally* A. BICKS, CONTRACTS FOR THE SALE OF REALTY 25 (rev. H. Glassner and W. Kufeld 1966) [hereinafter cited as A. BICKS].

[9]J. WEBSTER § 362, at 489.

[10]A. CASNER § 11.35, at 101.

must be paid by the buyer in the absence of contractual provisions to the contrary.[11] Such assessments imposed for county or city improvements are frequently termed "special assessments." Special assessments by law are not a lien until the assessments are confirmed by the relevant authority—usually a municipality.[12] The city generally will not assess the landowner until the work is complete and costs have been totaled and apportioned among those liable for the improvements costs. There is frequently a time lag of months or even years between the date of improvement and the date of assessment. Thus, for example, a sidewalk may have been completed at the time of closing and the seller will not know that the cost will be a lien against the property. The buyer likely will assume that the cost of the improvement has been paid.

The relative equities of the buyer and seller must be examined to see if there is a need to contractually modify the common law results. The buyer usually feels that the seller should pay for all assessments arising prior to closing whether they are payable at closing or not. The ordinary buyer would be induced to purchase the property by viewing it as improved. Part of the consideration he bargains for is the improvement. Later, if he learned of an assessment, he would feel that he is being forced unfairly to pay twice for the improvement.[13] Furthermore, he would feel with considerable justification that the seller was the party best able to know of the existence of the lien.[14] Therefore, equity seems to dictate that the seller should have to pay for the improvement.

The Association's contract is unclear as to who must pay for such assessments. It states as follows: "The buyer agrees to purchase . . . free and clear of all encumbrances except . . . taxes . . . zoning regulations, restrictive covenants and easements of record, if any; and such other conditions as may be hereinafter stated." The contract thus implies that if the assessment is an encumbrance and has not been listed in the contract, the seller has failed to meet a condition precedent to the contract. Thus, by implication, under this contract the buyer might be able to obtain rescission or even have the seller pay the assessment. The remedies available are unclear from the wording of the provision. To eliminate this ambiguity, the contract should specifically state which

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[11]Friedman, *Buying a Home: Representing the Purchaser*, 47 A.B.A.J. 596, 600 (1961).

[12]*See generally* N.C. GEN. STAT. §§ 160A-216 to -236 (1972) for municipalities' authority to make special assessments. Also *id.* § 160A-233(c) (1972) provides that priority be given such special assessments over all other liens except local, state and federal government taxes.

[13]A. BICKS 15.

[14]Committee on Real Property of the Chicago Bar Association, *Drafting of Real Estate Sales Contracts*, 35 CHICAGO B. RECORD 247 (255 (1954).

party will bear the responsibility for such payments. One solution is for the drafter of the form contract to balance the equities of both the buyer and seller and then draft the contract in the manner he considers most equitable. If the party who must pay is the seller, the buyer's remedies for the seller's failure to pay should also be specified. Another method would be to leave a blank space for the individual buyer and seller to decide themselves who must pay and what remedies are needed. The latter solution is preferable in that it most clearly reflects the desired bargain of the parties. However, that solution may be difficult to handle in a form contract because of the very technical points of law which would need to be explained.

Marketable Title Exceptions

The Association of Realtors' contract provides for marketable title exceptions as follows: The seller must "convey a good and marketable title free and clear of all encumbrances except . . . zoning regulations, restrictive covenants and easements of record, if any . . . ." The buyer under the Association's contract thus cannot object to zoning regulations, restrictive covenants, and easements as making the title unmarketable.

Ordinarily this form of encumbrance does not interfere with the buyer's use and possession of the property. However, when blanket exceptions are granted, as in the Association's contract, problems may arise. For example, a blanket exception for zoning does not provide for problems of existing nonconforming uses in light of the buyer's intended special use of the property. A nonconforming use is a right to continue a use in violation of the zoning ordinance where that use was legal before the change in zoning.[15] For example, a seller may have been using his property as a business prior to enactment of zoning for residential use only. He may be able to continue this use (a nonconforming use) after the zoning change. The right to continue such a use may, however, be lost through destruction of the premises or damage requiring repairs in excess of some amount.[16] The buyer who purchases with the intent to continue that use runs a serious risk that he may lose the right to continue it. This is especially onerous if the buyer is not even aware that the property is in violation of any zoning ordinance. To alleviate this

[15]M. FRIEDMAN, CONTRACTS AND CONVEYANCES OF REAL PROPERTY § 3.8, at 135 (2d ed. 1963).

[16]*Id.* § 3.8, at 136.

difficulty, the contract should specify that the buyer takes subject to zoning restrictions provided that the present use of the premises is not nonconforming.

The buyer may also intend to put the property to a different use. After signing the contract, he may find that his intended use is prohibited. The contract of sale could provide protection to buyers who intend special use of the property[17] as follows: "The buyer's agreement to purchase is conditional upon the property presently being zoned for _____ purposes."

Easements and restrictive covenants similarly may be a problem to the buyer under certain circumstances. The contract, after weighing the relative equities of the buyer and seller, might allow the buyer to rescind the contract if any unusually onerous restriction is found prior to closing. The purchaser could be protected by a clause stating that "the buyer takes subject to easements of record and restrictive covenants which do not materially impair the value of the property to the buyer."

Remedies upon Default or Termination

The North Carolina contract's sole provision for remedies upon default or termination of the contract provides as follows: "In the event either party fails to sign this contract, or if the Buyer is unable to secure a loan as hereinabove described, or if the Seller is not able to convey a good and marketable title, any deposit made as a part of the purchase price is to be returned to the Buyer and this contract shall thereafter be null and void."

The contract does not specify other conditions under which the deposit would be returned or other remedies which would be available to the buyer if the seller defaults. It also fails to specify whether retention of the deposit should be the seller's exclusive remedy if the buyer defaults. These remedies should be provided in the contract to give guidelines for settlement of differences without resort to a suit.

Deed

The Association's contract fails to guarantee the buyer an accepted form of title assurance because it makes no provision for the form of

[17] *Id.* § 3.6, at 126. The buyer should, of course, check each of these potential encumbrances before signing the contract of sale. J. WEBSTER §§ 401-02, at 607, 609-10. Ordinarily, though, this is not done until the title search by the attorney after the contract is signed. Furthermore, a large percentage of North Carolina attorneys do not check these restrictions. Whitman, *supra* note 2, at 430-31.

deed by which the seller is to convey the property. The two most common deeds in North Carolina are general warranty and quitclaim deeds. In a quitclaim deed the seller "merely conveys the right, title and interest, if any, of the grantor at the time the deed is made."[18] The buyer has no cause of action for title defects. In a warranty deed the seller promises through a series of present and future covenants that he is conveying good title.[19] A purchaser has the right to sue the seller on the covenant for defects in title. Recovery under a warranty deed will, however, depend on the seller's amenability to suit and financial ability to make good on the warranty. The warranty deed may be an inadequate means of title assurance in some circumstances[20] but does, nevertheless, provide greater protection thatn the quitclaim deed.

The warranty deed is customarily used in North Carolina real estate transactions.[21] However, unless the contract of sale so specifies, the seller is under no legal obligation to give a warranty deed. The buyer might well be forced to accept whatever form of deed the seller chooses to give.[22] To avoid such an occurrence, the contract should provide that the conveyance is to be by warranty deed. An argument to the contrary holds that because the contract requires the seller to give marketable title,[23] it is unnecessary to provide for a warranty deed.[24] A contract to deliver marketable title provides less protection to the buyer, however, because the contract of sale merges into the deed and loses its legal effect. Thus the marketable title clause is of no use to the buyer after the closing. On the other hand, the buyer can sue on the deed covenants after the closing unless the suit is barred by the applicable statute of limitations.[25] Therefore, the contract of sale, in order to provide the title

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[18]Hayes v. Ricard, 245 N.C. 687, 97 S.E.2d 105 (1957).

[19]Spencer v. Jones, 168 N.C. 291, 84 S.E. 261 (1915). *See also* J. WEBSTER § 127, at 159. For discussion of the legal effect of these covenants see note 25 *infra*.

[20]Whitman, *supra* note 2, at 460.

[21]*Id.*

[22]The North Carolina law on this point is unclear. Apparently, unless there is some affirmative decision to the contrary (and there appears to be none in North Carolina), a seller need not deliver a warranty deed unless he has agreed to do so. A. BICKS 70-71; M. FRIEDMAN, *supra* note 15, § 7.1.

[23]Contracts of sale usually provide that the seller give marketable title. This is also an obligation implied by law. The buyer would thus have a cause of action for matters making the title unmarketable such as mortgages and other encumbrances, restrictive covenants and leases. Friedman, supra note 11, at 600.

[24]A. BICKS 70.

[25]Covenants of seisin and against encumbrances are present covenants broken, if at all, at the time they are made. The statute of limitations for breach of such promise begins to run from the accrual of the cause of action—the making of the promise. However, a covenant to warrant and defend title is not deemed to be breached until there has been either actual or constructive eviction.

assurance which the buyer needs, should specify that the transfer is to be by warranty deed. If the seller and buyer should agree to the contrary, they can alter the contract accordingly.

Form of Tenancy

Another area not covered by the contract is the form of tenancy by which the buyers (if there is more than one) will be deeded the property. If the buyers are husband and wife, as is frequently the case, they are presumed to take the property in a tenancy by the entirety.[26] In North Carolina transactions, as a general rule, married persons are not informed of the legal ramifications of ownership by the entirety.[27] These legal effects include limitations on the right to management of the property,[28] restrictions on the claims of creditors,[29] automatic devolution of the property on the death of one tenant,[30] and taxation of the property to the estates of both spouses.[31] The parties should have the opportunity to explore which tenancy best meets their individual needs. To emphasize the need to make a conscious decision, the contract of sale might provide "the form of tenancy in the deed shall be _____." The problem with this approach is that the effect of the tenancy chosen is a complicated legal matter either beyond the knowledge of or not properly handled by the real estate broker. The parties need professional legal advice on this issue.

Thus the statute of limitations begins to run at the time of ouster. This gives the covenantee protection in the event of disturbance of his title at a future date when the statute of limitations might already have run on a cause of action for the other deed covenants mentioned. Shankle v. Ingram, 133 N.C. 254, 45 S.E. 578 (1903); Wiggins v. Pender, 132 N.C. 628, 44 S.E. 362 (1903).

[26]Bowling v. Bowling, 252 N.C. 527, 530, 114 S.E.2d 228, 231 (1960); Moore v. Greenville Banking & Trust Co., 178N.C. 118, 123-24, 100 S.E. 269, 272 (1919).

[27]Whitman, *Transferring North Carolina Real Estate Part II: Roles, Ethics, and Reform*, 49 N.C.L. REV. 593, 631.

[28]In North Carolina the husband in a tenancy by the entirety has the right to the control, possession, rents, and profits of the property during the tenancy. *In re* Perry's Estate, 256 N.C. 65, 70, 123 S.E.2d 99, 102 (1961); Smith v. Smith, 255 N.C. 152, 156, 120 S.E.2d 575, 579 (1961). *See* Lee, *Tenancy by the Entirety in North Carolina*, 41 N.C.L. REV. 67, 78-84 (1962).

[29]Creditors of one spouse alone can not reach property held by the entirety through judgment and execution. For example, a creditor of the husband alone can reach the property neither during the tenancy nor after the termination of the tenancy by death of the husband. Bruce v. Nicholson, 109 N.C. 202, 13 S.E. 790 (1891). *See generally* Lee, *supra* note 28, at 84-88.

[30]Devolution of the property on the death of one tenant by the entirety automatically vests sole ownership in the entire property in the survivor. Underwood v. Ward, 239 N.C. 513, 80 S.E.2d 267 (1954). *See generally* Lee, *supra* note 28, at 91-92.

[31]For tax consequences of tenancy by the entirety *see* P. ANDERSON, TAX FACTORS IN REAL ESTATE OPERATIONS 24-30 (3d ed. 1969).

Need for Attorney Clause

The need of both buyer and seller for competent legal advice before executing a contract of sale has been mentioned throughout this note. A contract of sale is a technical document with significant effect on the legal rights and obligations of the buyer and seller in a relatively expensive and important transaction. Even the best form contract is no substitute for legal advice.

The parties, of course, must decide for themselves whether or not to seek legal advice before signing the contract. The real estate broker could, however, encourage this action through insertion in the contract of a clause similar to the following: *"A real estate broker is the person qualified to advise on real estate. If you desire legal advice consult your attorney."*[32]

Other Provisions

In addition to the provisions previously discussed, there are a number of other issues raised by the Association's contract which are worthy of consideration. Due to space limitations, they will be noted but not developed in depth.

1.) The condition that the buyer be able to obtain a loan on certain terms is generally well drafted. It contains the necessary terms of the loan and provides that the buyer must use "his best efforts" to secure such a loan. It prevents a challenge to the contract for indefinite terms or lack of mutuality of commitment of the parties.[33] The provision could be improved by providing flexibility to reflect changes in the lending market.

2.) The method of payment, escrow, and closing provisions could be more specifically stated. For instance, the closing provision should specify date, time, and place of closing. Also matters to be handled at closing, such as delivery of existing notes or proof of cancellation by the seller of any charges against the property, could be listed.[34]

3.) The date of proration of rents and charges upon the property such as taxes should be specified as either the closing date or the date of delivery of possession depending upon the draftsman's choice or the equities of the parties.

4.) Title insurance, merger of the contract into the deed, and

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[32]Whitman, *supra* note 27, at 631.

[33]Friedman, *supra* note 11, at 603.

[34]Whitman, supra note 2, at 463.

assignability of the contract should also be considered.

5.) Warranty disclaimer through an integration clause, desirable to the seller, and specific warranties desired by the buyer are additional terms to consider.

6.) A final issue to be mentioned is risk of loss between the signing of the contract and the closing of the transaction. The Association's contract makes no provision for this, leaving the Uniform Vendor and Purchaser Risk Act to control.[35] This act seems an equitable method to allocate the risk of loss. It does not, however, clarify the remedies which are to be available or cover other problems such as distribution of insurance proceeds or determination of the "materiality of the loss" which should be covered in the contract of sale.[36]

Conclusion

The buyer and seller in a typical real estate sale enter into an important and expensive transaction. To protect their interests in this transaction, they need legal advice or, at least, a contract which reflects their individual needs.

The contract of sale of the North Carolina Association of Realtors is an improvement upon many form contracts in coverage of legal issues and achievement of an equitable balance of interests of both parties.[37] The Association of Realtors' contract, nevertheless, needs much improvement. It contains gaps in legal protection such as the failure to assure the buyer a right to a warranty deed. Further, the contract may encourage disputes between the parties over such matters as title to personal property, liability for special assessments, or remedies upon default or termination of the contract. The contract would be improved by broader coverage and greater specificity to prevent such gaps in legal protection and potential disputes between the parties.

ELIZABETH HAZEN POPE

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[35]N.C. GEN. STAT. §§ 39-37 to -39 (1966).

[36]A further potential problem is raised concerning the scope of the act. The original proposed act applied "when . . . all or a material part thereof is destroyed without fault of the purchaser or is taken by eminent domain." UNIFORM VENDOR AND PURCHASER RISK ACT. The North Carolina act, however, omitted the language "or is taken by eminent domain." N.C. GEN. STAT. § 39-39 (1966). It could be inferred that the General Assembly intended the act not to apply to loss from takings by eminent domain. The contract, therefore, might well make provision to allocate this loss.

[37]Some contracts provide little more than the parties' names and the purchase price. Also many contracts used by real estate brokers are weighted heavily in favor of the seller. *See*, for example, form Contract of Sale printed by Kale-Lawing Co., Charlotte, N.C. and obtained from the National Association of Realtors. A copy is on file with the *North Carolina Law Review*.

APPENDIX: CONTRACT OF SALE

This contract made the ____ day of _____, 19__, between _____ hereinafter referred to as the Buyer, and _____ hereinafter referred to as the Seller,

WITNESSETH, that the Buyer agrees to purchase and the Seller agrees to sell and convey all that certain plot, piece, or parcel of land together with improvements located thereon, in the City of _____, County of _____, State of _____, being known as and more particularly described as follows: _____ _____ conditional upon the Seller being able to convey a good and marketable title free and clear of encumbrances except ad valorem taxes for the year in which the property is conveyed (the taxes for the real property are to be prorated on a calendar year basis to the date of final settlement and any taxes for personal property are to be paid by the Seller or if not then payable credited to the Buyer), zoning regulations, restrictive covenants and easements of record, if any; and such other conditions as may be hereinafter stated.

The contract price for said property is $ _____ and shall be paid as follows:

1. $_____, with the signing of this contract, to be held in escrow by _____ as agent, until this sale is closed, or this agreement is otherwise terminated as hereinafter provided;
2. $_____, by the assumption of the unpaid balance on an existing mortgage as of _____ (this item No. 2 to be adjusted to the exact balance of the mortgage on the date of closing);
3. $_____, by a promissory note of the Buyer secured by a purchase money deed of trust on the above described property payable $ _____ per _____ including interest at the rate of ____% per annum _____
4. $_____, the balance of the purchase price, in cash upon delivery of the deed and the closing of this transaction. (The amount of this item No. 4 is to be adjusted as may be necessary because of any change in the balance of the mortgage assumed as stipulated in item No. 2 above).

The contract is conditional upon Buyer being able to secure a loan in the principal amount of $_____ for a term of ____ years, at an interest rate not to exceed ____% per annum using the above described property as security. Buyer agrees to use his best efforts to secure such a loan and to pay the usual cost in connection therewith provided; however, that in the event Buyer is unable to obtain a loan commitment as herein described on or before _____, 19__, this contract shall be null and void.

Rents, if any, for the subject property are to be prorated to the date of closing and delivery of the deed.

Other Conditions:

The Buyer and the Seller agree to execute any and all other documents or papers that may be necessary in connection with the transfer of title. Final settlement shall be on or before _____, 19__, with the deed to _____. Possession of the property will be delivered _____.

In the event either party fails to sign this contract, or if the Buyer is unable to secure a loan as hereinabove described, or if the Seller is not able to convey a good and marketable title, any deposit made as a part of the purchase price is to be returned to the Buyer and this contract shall thereafter be null and void.

The Buyer acknowledges that he has inspected the above described property, that no representations or inducements have been made other than those expressed herein, and that this contract contains the entire agreement between the parties hereto.

IN WITNESS WHEREOF, the parties hereto have signed or caused this agreement to be executed in _____ counterparts effective the date and year first above written.

_____ _____
Buyer Seller

_____ _____
Buyer Seller

_____ joins in this agreement as escrow agent to acknowledge receipt of the deposit set out in Item No. 1 above and the trust created by the deposit of such funds.

_____

Standard Form No. 8

Revised 1967

NORTH CAROLINA ASSOCIATION OF REALTORS, INC.

P.O. Box 6306, Greensboro, N.C.

Securities Regulation—Amendment of the Social and Political Exclusion for Shareholder Proxy Proposals

The Securities and Exchange Commission (SEC) recently adopted certain amendments to its rule governing shareholder proxy solicitations.[1] Probably the most important amendment is the revision in rule 14a-8(c)(2), which deals with the right of management of a corporation to exclude from its proxy statement a shareholder proposal dealing with a general social or political issue. This revision is the latest development in the growing management-shareholder controversy over the proper scope of shareholder initiative in forming corporate policy.

In order to increase shareholder participation in the governing of corporations, the Securities and Exchange Act of 1934 empowered the SEC to make rules governing the solicitation of proxies by any person in respect of any security registered under the Act.[2] Nevertheless, it was not until 1942 that the SEC implemented the statute with a rule requiring management to include in its annual proxy statement a shareholder proposal to be made at the annual shareholder meeting.[3] The rule carried the limitation that management could omit a shareholder proposal from the proxy statement if it concerned a matter that was not a "proper subject" for shareholder consideration under the law of the state of incorporation.[4]

In 1945, in upholding a corporation's decision to omit from its proxy statement a shareholder proposal calling for a revision of the tax and antitrust laws,[5] the SEC decreed that shareholder proposals dealing with matters of general political or social concern could be categorically omitted from management's proxy statement.[6] The release stated that the rule was intended to force inclusion only of proposals directly relating to the corporation's affairs.[7] This decision was generally interpreted

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[1]SEC Securities Exchange Act Release No. 9784, 2 CCH FED. SEC. L. REP. ¶ 24,012 (Sept. 22, 1972), *amending* 17 C.F.R. § 240.14a-8 (1971).

[2]Securities Exchange Act of 1934 § 14a, 15 U.S.C. § 78n(a) (1970).

[3]SEC Securities Exchange Act Release No. 3347, 7 Fed. Reg. 10656 (Dec. 18, 1942).

[4]*Id.*

[5]SEC Securities Exchange Act Release No. 3638, 11 Fed. Reg. 10995 (Jan. 3, 1945). The specific proposals omitted were for an end to "double taxation" of dividends, a revision of the antitrust laws and their enforcement, and a requirement that all federal laws providing for worker and farmer representation also provide for investor representation.

[6]Allen, *The Proxy System and the Promotion of Social Goals*, 26 BUS. LAWYER 481, 485 (1970).

[7]The release said that:

> [I]t is the purpose of Rule X-14a-7 [now 14a-8] . . . to place stockholders in a position to bring before their fellow shareholders matters of concern to them as stockholders in

as drawing a distinction between proposals over which the corporation had the power to act, which would be includible in management's proxy statement, and those matters of *general* interest to all citizens over which it had no power to take any action and which therefore belonged in another forum.[8]

In 1951 this distinction was judicially expanded[9] when a federal district court approved an SEC decision to allow Greyhound Corporation to omit a shareholder proposal "to consider the advisability of abolishing the segregated seating system in the South."[10] Seemingly the corporation had power to act on this proposal, at least to consider abolishing segregated seating on its buses, and therefore the proposal should not have been omittable as a general social matter under the interpretation generally ascribed to the 1945 release.[11] (A mandate that Greyhound actually abolish segregated seating on its buses would have been to no effect, however, since in several southern states at that time such action would have been illegal. As a result, all Greyhound could do was "consider the advisability" of integrating its buses.[12]) Perhaps the court's holding can be best explained by assuming that the determinative factor was the purpose of the shareholder in advancing the proposal rather than the relation of the proposal to the corporation's business.[13]

In 1952 the SEC explicitly codified the 1945 release by providing in rule 14a-8(c)(1) that management may omit a shareholder proposal "if it clearly appears that the proposal is submitted by the securityholder . . . primarily for the purpose of promoting general economic,

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such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized. It was not the intent of [the rule] to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social, or economic nature. Other forums exist for the presentation of such views.

SEC Securities Exchange Act Release No. 3638, 11 Fed. Reg. 10995 (Jan. 3, 1945).

[8]Schwartz, *The Public-Interest Proxy Contest: Reflections on Campaign GM*, 69 MICH. L. REV. 421, 440-41 (1971) [hereinafter cited as Schwartz].

[9]*Id.* at 442.

[10]Peck v. Greyhound Corp., 97 F. Supp. 679 (1951). The resolution dealt with by the court in *Peck* is the single litigated proposal dealing with a moderate social issue up until 1969. Manne, *Shareholder Social Proposals Viewed by an Opponent*, 24 STAN. L. REV. 481, 486 (1972) [hereinafter cited as Manne].

[11]SEC Securities Exchange Act Release No. 3638, 11 Fed. Reg. 10995 (Jan. 3, 1945).

[12]Schwartz 441.

[13]Note, *Corporate Political Affairs Programs*, 70 YALE L.J. 821, 846 (1961). Precisely how much weight should be given to the judicial sanction of the SEC's no-action letter in *Peck* is unclear because the court's opinion dealt only with administrative remedies and never addressed the merits.

political, racial, religious, social or similar causes."[14] Under this provision a decision as to whether or not a proposal was excludable invariably required an examination of the proponent's motives in making the proposal. This resulted in the exclusion of shareholder proposals, whatever their relevance to the business of the corporation, if the SEC determined that they were motivated primarily by concern for political or social issues.[15]

Concern with the motives of shareholder-proponents has been the most strongly criticized aspect of the political and social exclusion of rule 14a-8. In addition to permitting omission of proposals which are otherwise proper subjects for shareholder consideration, it has required that the primary purpose be deciphered from among all the varied purposes a shareholder may have in offering a proposal. Furthermore, the SEC had to undertake this task "without psychological expertise and often without more evidence than papers drafted by the shareholder's lawyer." Such a subjective test of purpose gave the SEC "wide discretion to make arbitrary rulings."[16]

The concern with motives has also resulted in the anomalous situation of some public-interest questions being excluded "although they dealt with subject matters that another shareholder might have been allowed to raise,"[17] often because an improper motive was inferred from an association of the shareholder with a certain political or social cause.[18] An additional problem with the rule was its failure to give the socially concerned shareholder a clearly defined guideline as to which proposals could be included in management's proxy statement. In addition to the inherent ambiguity of the rule and the lack of judicial caselaw on the subject, the SEC published no compendium of rulings and generally gave no reasons for its decision in any given case.[19] This lack of

[14]SEC Securities Exchange Act Release No. 4775, 17 Fed. Reg. 11433 (Dec. 11, 1952). The Director of the Division of Corporate Finance of the SEC said that the purpose of the revision was to codify the 1945 release. Schwartz 442.

[15]Heller, *Stockholder Proposals*, 4 VA. L. WEEKLY *DICTA* COMPILATION 72, 73-74 (1953) [hereinafter cited as Heller].

[16]Note, *Liberalizing SEC Rule 14a-8 Through the Use of Advisory Proposals*, 80 YALE L.J. 845, 855-56 (1971).

[17]Schwartz 448.

[18]Heller 74. Examples of proposals excluded under 14a-8(c) (2) largely because of an association of the proponent with a social cause were proposals that a corporation cease investing in liquor stocks and that women employees be given the same pension rights as men. *Id.*

[19]Schwartz 443. 17 C.F.R. § 200.81(c) (1971) provides that the SEC need not make public any letters of comment or other communications relating to the adequacy of any proxy filed with the Commission. A reason given for this is that material in a shareholder's proposal may be

disclosure led to a paucity of information as to the specific standards used by the SEC in deciding which shareholder proposals violated the political and social exclusion.

The thrust of the arguments used to justify the exclusion was that it "operated to exclude frivolous and crackpot proposals as well as those motivated solely by considerations extraneous to the welfare of the particular company."[20] A stockholder who owned a nominal share of a corporation, which he had purchased only so that he would be able to use the corporation's proxy machinery, should not be permitted to put the company to the expense of providing him with a sounding board for his political and social beliefs.

In 1969 another rare judicial sanction was added to the rule when a court permitted the exclusion of a proposal for an oil company to encourage underwater oil exploration and the creation of a "stable international regime" to help foster this.[21] In 1970 a group called Campaign to Make General Motors Responsible, popularly known as Campaign GM, sought inclusion of nine proposals calculated to stimulate public debate on the role of corporations in the economy.[22] Under the prevailing interpretation of the political and social exclusion, all of the proposals should have been excluded because the admitted purpose of the proponents was to bring about social change.[23] Seven of the proposals that specifically dealt with social policy issues were in fact excluded.[24] One proposal—to increase the board of directors by three members—was ordered included as written, probably because it did not show any social motivation on its face and because enlarging the board of directors has traditionally been considered to be within the shareholder's sphere of initiative.[25] The other proposal ordered included called for the establishment of a shareholder Committee for Corporate Responsibility.[26] Perhaps the two proposals were included because if General Mo-

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"misleading" to the public. Telephone interview with Peter Romeo of the SEC, March 1, 1972. As part of the recent amendments, however, the SEC also changed this rule so as to treat material filed with it regarding shareholder proposals as matters of public record. SEC Securities Exchange Act Release No. 9785, 3 CCH FED. SEC. L. REP. ¶ 66,482 (Sept. 22, 1972).

[20]Heller 77.

[21]Brooks v. Standard Oil Co., 308 F. Supp. 810 (S.D.N.Y. 1969). As was the case in Peck v. Greyhound Corp., 97 F. Supp. 679 (1951), the court here also failed to specify the particular exclusion under which it upheld the decision to omit the shareholder proposal.

[22]For a thorough review of the Campaign GM experience see Schwartz 421.

[23]Comment, *A Judicial Challenge to the SEC's Shareholder Proposal Rule,* 28 WASH. & LEE L. REV. 147, 154 (1971).

[24]Manne 487.

[25]Comment, 28 WASH. & LEE L. REV., *supra* note 23, at 155.

[26]Schwartz 453. The proposal for the shareholder committee was ordered included subject to

tors had been allowed to exclude all nine proposals, a public controversy might have arisen over the continued anti-shareholder attitude generally displayed by the SEC in its proxy rulings. The Campaign GM ruling was a facesaving compromise in that it "allowed the two proposals on which the strongest argument for inclusion could be made, while rejecting those without supporting precedent."[27]

The next break in the rule's interpretation, "one that shatter[ed] past assumptions . . . about the scope of" the rule,[28] was the decision of the Court of Appeals for the District of Columbia in *Medical Committee for Human Rights v. SEC.*[29] A group which had acquired a few shares of stock in Dow Chemical Company requested that Dow include in its proxy statement a resolution that any napalm it produced "shall not be sold to any buyer unless that buyer gives reasonable assurance that the substance will not be used on or against human beings."[30] The court held that the political and social exclusion could be applied only to proposals unrelated to a corporation's activities.[31] The court interpreted "the word 'general' in [the rule] as ruling out attempts to secure a consensus of shareholder opinion on political issues whose resolution is not within the corporate power, and distinguished the Medical Committee's proposal as relating 'to a matter that is completely within the accepted sphere of corporate activity and control.' "[32] The court viewed the exclusion as covering only proposals for *general* social reform, and not covering proposals for the corporation to conform to a particular ideology rather than to increase profitability.[33]

In addition, the court said that rule 14a was not designed to allow management to treat "modern corporations with their vast resources as personal satrapies implementing personal or moral predilections" free from shareholder interference. Because Dow's management had publicly stated that it was producing napalm for political—and not profit-making—reasons, the court implied that the Medical Committee's proposal might have to be included regardless of the proponent's motive in offering it.[34]

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certain revisions made by the SEC. *Id.*

[27]Manne 488.

[28]Chisum, *Napalm, Proxy Proposals and the SEC,* 12 ARIZ. L. REV. 463, 463 (1971).

[29]432 F.2d 659 (D.C. Cir. 1970), *vacated as moot,* 404 U.S. 403 (1972).

[30]432 F.2d at 662.

[31]432 F.2d 659 (D.C. Cir. 1970); *see* Comment, *Proxy Rule 14a-8: Omission of Shareholder Proposals,* 84 HARV. L. REV. 700, 723 (1971).

[32]Comment, 28 WASH. & LEE L. REV., *supra* note 23, at 151.

[33]Chisum, *supra* note 28, at 472-73.

[34]432 F.2d at 681. The idea was that "management has no right to operate the corporation

Thus the *Medical Committee* court seemed to return to the pre-1951 interpretation of the political and social exclusion under which the personal "philosophy that may have motivated the resolution is irrelevant."[35] The SEC apparently acquiesced in this interpretation,[36] as it appealed only the administrative law question of whether an SEC no-action letter was judicially reviewable.[37] Since the *Medical Committee* decision, the SEC has ordered the inclusion of a shareholder proposal in a mutual fund's proxy statement requiring the fund to take into consideration before investing in any corporation: (1) the corporation's record in pollution control; (2) its record in complying with the civil rights laws; and (3) "whether the corporation has invested in South Africa, Rhodesia, or Angola, and if so, what action it has taken to" change those countries' oppressive political practices.[38] It would seem that under the interpretation of the rule prevailing between the *Greyhound* case in 1951 and the *Medical Committee* case this proposal would have been clearly omittable by management.

The new rule 14a-8(c)(2) (ii)[39] provides that management may omit a shareholder proposal if it "consists of a recommendation, request or mandate that action be taken with respect to any matter, including a general economic, political, racial, religious, social or similar cause, that is not significantly related to the business of the issuer or is not within the control of the issuer." The release announcing the amendments comments that the revision was designed to replace the subjective terms of the rule with objective standards in order to reduce uncertainty in applying it.[40]

Undoubtedly the new provision is an improvement over the old one. It does away with the need to examine the motives of shareholder-proponents of political and social proposals and thus dispenses with the most subjective element of the old rule. It also furnishes a clearer guideline as to which proposals violate the social and political exclusion. However, the rule does not seem to be of sufficient clarity to create true certainty in application.

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in a manner designed to advance its own social, political, or moral goals to the exclusion of the goals sought by the shareholders." Allen, *supra* note 6, at 492.

[35]Schwartz 461.

[36]Manne 489-90.

[37]*See* SEC v. Medical Committee for Human Rights, 404 U.S. 403 (1972).

[38]Letter from Division of Corporate Regulation, SEC, to Fidelity Trend Fund, Inc., in [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,070 (May 19, 1972).

[39]SEC Securities Exchange Act Release No. 9784, 2 CCH FED. SEC. L. REP. ¶ 24,012 (Sept. 22, 1972).

[40]SEC Securities Exchange Act Release No. 9784 (Sept. 22, 1972).

The greatest difficulty in applying the new rule will probably stem from the interpretation of the phrase, "significantly related to the business of the issuer." This may be a financial[41] or quantitative[42] relation, in the sense that the activity to which the proposal is addressed must constitute a large and important portion of the corporation's business activity for the proposal to be allowed. If so, the amendment will likely serve as a retreat from the decision in the *Medical Committee* case because the production of napalm was such a small fraction of Dow's operations that a shareholder proposal dealing with it would not be "significantly related" to Dow's business. However, if this interpretation were adopted, it would render the "significantly related to" language of (c)(2) meaningless from redundancy, because rule (c)(5)'s[43] proscription of shareholder proposals relating to the "conduct of ordinary business operations" would presumably apply to proposals dealing with insignificant aspects of the corporation's business.[44]

Alternatively, the phrase "significantly related" may refer to a relationship based on the nature of the business conducted by the company. For example, "a question concerning off-shore oil drilling could be significantly related to the business of a corporation in the business of producing oil even if that corporation did not itself conduct any off-shore oil drilling."[45] If such an interpretation were adopted, the rule would not provide an objective, workable guideline for the inclusion of shareholder proposals. Legitimate shareholder-management disagreements over the relation of the business with the political or social issue involved would be inevitable as it would be very difficult to show convincingly that a company's operations do not have an impact on a given social or political cause. A proponent could usually establish the relevancy of his social or political proposal to the corporation in any case. Thus it would be difficult for management to effectively characterize

[41]Letter from Gerald V. Niesar, Chairman, Corporations Committee, Barristers Club of San Francisco, to Charles J. Sheppe, Chief, Branch of Regulations and Legislative Matters, Division of Corporate Finance, SEC, Feb. 2, 1972.

[42]Letter from Martin Riger, Professor of Law, Georgetown University Law Center, to Charles J. Sheppe, Chief, Branch of Regulations and Legislative Matters, Division of Corporate Finance, SEC, Feb. 3, 1972.

[43]Rule 14a-8(c)(5), 17 C.F.R. § 240.14a-8 (1971).

[44]Nevertheless, this seems to be the interpretation favored by Professor Schwartz, who believes that the proposal is "probably intended to confine shareholders to consideration only of questions of policy as contrasted with the minutiae of daily business as discussed in the *Medical Committee* case." Letter from Donald E. Schwartz and Roger Foster to Charles J. Sheppe, Chief, Branch of Regulations and Legislative Matters, Division of Corporate Finance, SEC, Feb. 1, 1972.

[45]Letter from Gerald V. Niesar, *supra* note 41.

most well drafted proposals as not "significantly related to the business" of the corporation.

The alternative ground for excluding shareholder proposals (if they are not "within the control of the issuer") also contains a serious constructional problem. The SEC was obviously aware of the difficulties of interpreting this language because the only change it made in the rule as initially suggested[46] was to note that a proposal is not within the issuer's control if it does not have the power to "effectuate it." Even with this clarification, a major constructional problem remains as to exactly what must be within the corporation's control: the specific proposal offered by the shareholder or the ultimate political or social situation at which it is directed. The shareholder proposal mentioned earlier[47] which dealt with a corporation's investments in certain repressive countries illustrates this problem. In that proposal a shareholder requested that management take into consideration the racial policies of certain countries before investing in them. The corporation had the power to "effectuate" such consideration before making its investments, but obviously there was very little the investment company could do to "effectuate" change in the racial policies of the countries. Whether or not the new rule will permit exclusion of such shareholder proposals in the future cannot be predicted until this constructional problem is resolved, but it would seem that the "control" language would generally exclude such proposals. Nevertheless, in the context in which the SEC adopted the changes in rule 14a, it is unlikely that the SEC has retreated from the position it adopted after the *Medical Committee* decision, and there-

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[46]SEC Securities Exchange Act Release No. 9432, 36 Fed. Reg. 25432 (Dec. 22, 1971).

[47]*See* text accompanying note 38 *supra.*

[48]During the period allowed by the SEC for comments concerning the rule's proposed revision, the theme was constantly heard from management forces that the proxy rules should not permit inclusion of *any* proposal of a social or political nature. The feeling generally expressed was that the attention of management should be solely directed at the earning power of the corporation, and therefore management should not be required to expend time and money to furnish a forum for those few shareholders whose interest is to publicize their personal] political and social beliefs without regard for the profitability of the issuer. It was frequently suggested that there be some minimum number of shares held by a shareholder-proponent or that he be required to hold his investment for a minimum period of time before being able to force inclusion of any proposal. Certainly there is merit to these suggestions in light of the great expense a corporation must incur in simply going through the process of clearing a decision to omit a proposal with the SEC and in light of the contemporary phenomenon that a few individuals may buy a single share in many companies and then send an identical lengthy list of proxy proposals to each. However, given the increasing centralization of economic power in fewer and fewer corporations, such corporations cannot avoid having a significant impact on the political and social life of the country and therefore any rule encouraging isolation of their managements from any shareholder views is probably ill advised.

fore the "control" language may not be interpreted as excluding proposals dealing with the racial policies of countries in which the issuer is investing.

Despite the ambiguities in the new rule, it can probably be said that it was intended to represent a liberalization of the political and social exclusion of shareholder proposals. Aside from the question of whether the SEC should have moved in this direction at all,[48] the changes seem to fall short of supplying a truly objective, workable guideline. It appears probable that, for the time being, the battle will shift from questions of whether a particular proposal stems from improper motives of the shareholder or whether such improper motives dominate his intentions to questions of whether the proposal is "significantly related to the business of the issuer" or whether it is "within the issuer's control."

CHARLES E. MURPHY, JR.

Securities Regulation—Rule 10b-5—An Alternative to Scalping Palefaces Who Speak with Forked Tongues

To implement section 10(b) of the Securities Exchange Act of 1934,[1] the Securities and Exchange Commission fashioned rule 10b-5,[2] which has become an expanding source of litigation for securities viola-

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[1]Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1970).

[2]The rule provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1971).

tions. Although neither section 10(b) of the Exchange Act nor rule 10b-5 specifically provide for the initiation of private causes of action, the federal judiciary has interpreted the rule to afford a remedy for persons injured as a result of a 10b-5 violation.[3] In addition to a flexible construction of rule 10b-5 permitting civil suits to be maintained by private individuals, many courts have begun to relax some of the restrictive elements of 10b-5 causes of action,[4] which often resulted in dismissals because of the plaintiffs' failure to state a claim.[5] Consequently, more plaintiffs suing under rule 10b-5 have been able to survive defense motions for directed verdicts and thereby enhance their prospects for favorable judgments. The remedies for violation of rule 10b-5 are not specified in the Exchange Act nor under rule 10b-5, so the courts have been faced with the problem of devising remedies for defrauded plaintiffs. In *Affiliated Ute Citizens v. United States*,[6] the United States Supreme Court has solved part of the problem by formulating a rule on the issue of compensatory damages to private party sellers.[7] This note will examine the alternative measures of damages that were available to the Court in arriving at a damage rule and will evaluate the Court's selection of a damage rule.

The *Affiliated Ute* case was initiated by mixed-blood Ute Indians[8] who sought damages against the United States, the First Security Bank of Utah, and two assistant managers of the bank for alleged violation of rule 10b-5. Under a plan formulated by the mixed-blood Utes for the distribution of assets to the individual members of their group, the Ute Distribution Corporation (UDC) was formed specifically to manage

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[3]The right to maintain a private action was initially recognized in Kardon v. National Gypsum Co., 73 F. Supp. 798, 800 (E.D. Pa. 1947). The United States Supreme Court recognized the right in Superintendent of Ins. v. Bankers' Life & Cas. Co., 92 S. Ct. 165, 169 (1971).

[4]Affiliated Ute Citizens v. United States, 92 S. Ct. 1456, 1472 (1972) (adoption of broad definition for materiality of mistatement and elimination of requirement of positive proof of reliance when there is a failure to disclose by one possessing such an affirmative duty); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968) (liberal construction of "in connection with" clause of rule 10b-5(c)); Texas Continental Life Ins. Co. v. Dunne, 307 F.2d 242, 249 (6th Cir. 1962)(abandonment of privity requirement).

[5]*See, e.g.*, Beury v. Beury, 127 F. Supp. 786, 790 (S.D.W. Va. 1954), *appeal dismissed*, 222 F.2d 464 (4th Cir. 1955); Joseph v. Farnsworth Radio & Television Corp., 99 F. Supp. 701, 706 (S.D.N.Y. 1951), *aff'd*, 198 F.2d 883 (2d Cir. 1952).

[6]92 S. Ct. 1456 (1972).

[7]Although rule 10b-5 applies to defrauded purchasers as well as to defrauded sellers, it is in the latter area that the Court has ruled on the damage issue. The scope of this note will be confined to 10b-5 actions brought by plaintiff sellers.

[8]The plaintiffs initiated the action, *Reyos v. United States*, in the United States District Court for the District of Utah, Central Division. Reyos v. United States, 431 F.2d 1337 (10th Cir. 1970).

mineral rights and unadjudicated claims against the United States under the Ute Partition Act.[9] UDC issued ten shares of its capital stock in the name of each mixed-blood Ute, a total of 4900 shares. The assistant managers of the bank, retained as transfer agent for UDC, had developed and encouraged a market in the stock, but they failed to inform the plaintiff sellers that their shares were selling for a higher price in the market and that the managers were in a position to gain financially from the plaintiffs' sales. After a reversal by the Tenth Circuit[10] of a generous award by the district court, the plaintiff Indians were granted a writ of certiorari by the United States Supreme Court.[11]

In its decision,[12] the Court affirmed the Tenth Circuit's refusal to award damages under the Tort Claims Act, since the government was under no duty to the plaintiffs.[13] However, the Court held that the managers' acts were clearly within the scope of rule 10b-5[14] and that the bank's liability was coextensive with that of the assistant managers.[15] Liability was predicated upon a relaxation of the requirement of positive proof of reliance.[16] Recognizing the right of the plaintiffs to recover under rule 10b-5, the Court turned to the damage issue[17] and made its first ruling on damages in a private action under rule 10b-5.

One recovery award available to private party sellers is rescission or damages equivalent to rescission. By rescinding the transaction, the defrauded seller would be made whole by a recovery of the securities which were sold as a result of the defendant's misrepresentation or failure to disclose.[18] By recovering damages equivalent to rescission, the defrauded seller would be awarded the securities' current value at the time judgment is rendered upon tender of the sale price.

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[9]§ 10, 25 U.S.C. § 677i (1970).

[10]Reyos v. United States, 431 F.2d 1337 (10th Cir. 1970).

[11]Affiliated Ute Citizens v. United States, 402 U.S. 905 (1971). The *Reyos* case was consolidated with another case, which centered on the Ute Partition Act, because of the issues for Indians whose federal supervision was in the course of termination. 92 S. Ct. at 1466.

[12]Affiliated Ute Citizens v. United States, 92 S. Ct. 1456 (1972).

[13]*Id.* at 1470. The Court reasoned that, since there was no governmental authority over the shares of UDC stock, there could be no liability on the part of the United States for failure to restrain a sale of the stock. Each mixed-blood could sell his shares as he wished and to whom he pleased, subject only to restrictions imposed by UDC's own articles.

[14]*Id.* at 1472.

[15]*Id.*

[16]*Id.*

[17]*Id.*

[18]Most 10b-5 cases turn on some material misrepresentation or on some failure to disclose. Even in cases which do not turn on misrepresentation or omission, these elements are almost invariably present. 2 A. BROMBERG, SECURITIES LAW: FRAUD § 8.2 (1971).

When the securities which the plaintiff was fraudulently induced to sell can be returned by the defendant at the same value at which the plaintiff sold the securities, both the fraudulent and defrauded parties can be returned to the *status quo ante*. However, the fair value of the securities at the time of the sale may have been greater than the value of the securities at the time of judgment, and the plaintiff would be in no better position after rescission than he enjoyed after the fraudulent conduct. For example, if defendant's fraudulent conduct induced the plaintiff to sell Security X at ten dollars per share when Security X would have been selling at fifteen dollars per share in the absence of defendant's fraud, and if Security X were selling at ten dollars per share at the time the judgment is rendered, rescission would return the parties to the *status quo ante* but would deprive the plaintiff of the value he should have received for his sale. In such a case, the injury to the plaintiff would not be rectified by rescission. The same is true when the value of the securities has fallen below the value at which the plaintiff sold. Indeed, rescission would then constitute a further injury to the plaintiff. Only when the current value of the securities is greater than the value at the time of the fraudulent transaction is rescission an attractive remedy to a 10b-5 plaintiff, since it affords the plaintiff a significant speculative advantage during the period within which an action might be brought.

Authority for allowing rescission in a 10b-5 cause of action is limited. In *Parker v. Baltimore Paint & Chemical Corp.*,[19] the court indicated that rescission was an available remedy so long as the plaintiff offered restoration of the consideration he received unless no consideration was received or unless the consideration received was worthless. However, the plaintiff's failure to state a claim upon which relief could be granted precluded such relief in that action. *Lanza v. Drexel & Co.*[20] is also indicative of a court's willingness to allow rescission in a 10b-5 cause of action. The court held that sellers of stock who were deceived by the buyers were entitled to rescind the transaction.

When rescission is impossible because the defendant has resold the securities to an innocent third party, an economic equivalent of rescission affords a comparable remedy.[21] A modification of this damage

[19]244 F. Supp. 267, 270 (D. Colo. 1965).

[20][1970-71 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,826 (S.D.N.Y. 1970).

[21]If the securities involved in the fraudulent transaction are traded on an open market and are readily accessible, the plaintiff can repurchase the securities and thereby effectively achieve rescission. If the securities involved in the fraudulent transaction are not accessible, the plaintiff must be satisfied with his damages.

formula was applied in *Janigan v. Taylor*,[22] in which the court awarded to the plaintiff the defendant's profit realized as the proximate consequence of the fraud[23] even though resale of the securities was not planned at the time of the fraudulent purchase. The court did not go so far as to suggest that the defendant would be liable for a subsequent appreciation in value after his sale to an innocent third party,[24] which would effectively give the plaintiff a "call" on the shares at the sale price until the statute of limitations has run against him.[25] In this respect, the *Janigan* award is distinguishable from the "call" which would be created by an economic equivalent of rescission.

The situations in which a plaintiff might request rescission in a 10b-5 cause of action are limited, since an award of damages might be a more attractive alternative, as noted above, and since the defendant in a 10b-5 action need not have purchased the securities to be liable under the rule.[26] Furthermore, a suit for rescission is subject to the equitable defenses of laches, estoppel, and waiver.[27] Additionally, rescission may subject a defendant to unwarranted liability in view of the relaxation of the elements of a 10b-5 cause of action,[28] and rescission gives to the plaintiff a speculative advantage he would not have enjoyed had he not sold the securities as a result of the fraud.

The most common judicial methods used to formulate 10b-5 awards for private party sellers[29] have been the cover theory and the out-of-pocket theory. The cover theory results in an award representing the difference between the sale price of the stock and the amount necessary to repurchase (cover) the stock within a reasonable time after the seller has become charged with notice of the true facts about the stock.[30] Under the out-of-pocket theory, the plaintiff is awarded the difference between the price he received and the real or actual value of the stock

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[22]344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965). *See also* Speed v. Transamerica Corp., 135 F. Supp. 176 (D. Del. 1955), *aff'd with modification as to interest*, 235 F.2d 369 (3d Cir. 1956); Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947).

[23]344 F.2d at 786.

[24]*See* note 21 *supra*.

[25]W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 121 (1968).

[26]In the *Affiliated Ute* case, the defendants' personal purchases comprised only 8 1/3% of the fraudulent sales. 92 S. Ct. at 1472.

[27]*See, e.g.*, Royal Properties, Inc. v. Smith, 312 F.2d 210, 213 (9th Cir. 1962); Walpert v. Bart, 280 F. Supp. 1006, 1017 (D. Md. 1967).

[28]*See* note 4 *supra*.

[29]Defrauded buyers who have prevailed on the merits have typically recovered their purchase price on a rescission measure of damages or under an out-of-pocket rule. 2 A. BROMBERG, *supra* note 18, § 9.1.

[30]Myzel v. Fields, 386 F.2d 718, 746 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

at the date of sale.[31] Both theories of recovery have been employed extensively with jurisdictional variations.

The historical development of the cover theory as a measure of damages began with the application of what has become known as the New York Rule.[32] The United States Supreme Court adopted the New York Rule in *Galligher v. Jones*,[33] in which the Court set the true and just measure of damages at the highest intermediate value of the stock between the time of conversion and a reasonable time after the owner of the stock received sufficient notice of the conversion to enable him to replace the stock.[34] The cover theory has subsequently been applied to 10b-5 actions, such as *Reynolds v. Texas Gulf Sulphur Co.*[35] The trial court applied the New York Rule to arrive at a damage formula based on the average of the highest daily price of the stock for twenty trading days after the misleading statement had been corrected.[36] The average which the court adopted as the measure of damages was 50.75 dollars per share. The appellate court assessed the damages under the cover theory at fifty-nine dollars per share by calculating the highest value of the stock between the time disclosure was sufficient for a reasonable and diligent investor to be informed of the correction and a reasonable time thereafter during which the investor had an opportunity to decide whether or not to reinvest.[37] Both the district and appellate courts attempted by their formulations to put the injured plaintiffs in the position they would have enjoyed if they had not sold at the time of the defendant's misleading statement.[38]

An award based on the cover theory may be arbitrarily discriminatory in litigation arising out of a factual setting similar to *Texas Gulf* in which there are multiple plaintiffs. A wealthy plaintiff with surplus

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[31]Kohler v. Kohler Co., 208 F. Supp. 808, 825 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963).

[32]The rule was initially enforced in Baker v. Drake, 53 N.Y. 211, 217 (1873), in an action brought for conversion. Valuation under the New York Rule has been subject to jurisdictional variation in applying the cover theory. *Compare id. with* Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 105 (10th Cir. 1971), *cert. denied*, 404 U.S. 1004 (1972).

[33]129 U.S. 193 (1889). The Court adopted the rule as a compromise between an out-of-pocket rule, which would not adequately compensate a victim of conversion, and an economic equivalent of rescission, which would be too burdensome on a defendant who might have to wait several years before the action was tried.

[34]*Id.* at 201.

[35]309 F. Supp. 548 (D. Utah 1970), *modified sub nom.* Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90 (10th Cir. 1971), *cert. denied*, 404 U.S. 1004 (1972).

[36]309 F. Supp. at 565.

[37]446 F.2d at 105.

[38]In this respect, the cover theory mirrors the purpose of rescission.

capital can evaluate the situation in light of the correction of the misstatement, decide that the wisest course is to reinvest, reacquire the stock within a reasonable period of time after the misstatement is rectified, and thereby take advantage of any subsequent rise in the price of the stock. On the other hand, an impecunious investor can draw the same conclusions but may be precluded from enjoying a subsequent rise in price. To illustrate, if the impecunious plaintiff sold Security Y at ten dollars per share because of some material misstatement and if the court, by applying a cover theory test for damages, determines that the plaintiff should have covered at twenty dollars per share to protect his interest in Security Y, the plaintiff will recover ten dollars per share. However, recovery will not permit the plaintiff to repurchase Security Y if, upon collecting the judgment at the conclusion of protracted litigation, Security Y is selling at thirty dollars per share.

Furthermore, in light of the liberalization of the "in connection with" clause of Rule 10b-5(c)[39] and in light of the uncertainty of the scienter requirement as an element of a 10b-5 cause of action,[40] the cover theory may subject a defendant to unwarranted liability.

A number of federal courts have recognized the out-of-pocket theory as an accurate measure of damages for 10b-5 violations.[41] The out-of-pocket theory relieves the court of the speculative task of assessing the seller's intentions regarding the disposition of the securities at some time subsequent to his actual sale. Likewise, the theory dispenses with the necessity to determine a reasonable period of time in which the seller would have, should have, or could have reinvested. More significantly, it places a limit on the liability of the defendant.

Despite these advantages, the out-of-pocket theory minimizes the deterrent quality of the Securities Exchange Act of 1934[42] and erodes the congressional purpose of achieving "a high standard of business ethics in the securities industry."[43] The out-of-pocket theory is, by itself, not sufficient to deter fraudulent conduct when the defendant retains the possibility of considerable gain from his misconduct. A fraudulent purchase at ten dollars per share of Security Z, which has an "actual value" of fifteen dollars per share, enables the wrongdoer to

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[39]*See* note 4 *supra*.

[40]It is uncertain whether Rule 10b-5 reaches negligent as well as intentional misrepresentation. Epstein, *The Scienter Requirement in Actions under Rule 10b-5*, 48 N.C.L. REV. 482, 503 (1970).

[41]*See, e.g.*, Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); Kohler v. Kohler Co., 208 F. Supp. 808 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963).

[42]15 U.S.C. §§ 78a to hh-1 (1970).

[43]SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

retain any profit he may have realized as a result of a rise in the market price above fifteen dollars per share. To allow him to profit by his wrongdoing offends not only the congressional intent[44] in the field of securities regulation but also basic equity principles.

It seems that the United States Supreme Court was cognizant of the advantages and disadvantages of the various damage theories when it made its initial ruling on damages in the *Affiliated Ute* case. The Court's measure of damages was the difference between the fair value of all the seller received and the fair value of what he would have received on the date of the sale had there been no fraudulent conduct,[45] except that when the defendant received more than the seller's actual loss, damages are the amount of the defendant's profit.[46]

In the *Affiliated Ute* case, the Court basically applied an out-of-pocket rule in arriving at the appropriate damages.[47] However, the Court's damage rule is not limited only to this case or to a case with the same factual pattern. The Court's alternative damage formula encompasses all fact situations in which the defrauded seller can prove a 10b-5 violation. The rule need not be restricted to face-to-face transactions in insignificant markets; it is especially appropriate for securities listed on major exchanges, because a fair value is more easily determined by substantial trading after the missstatement or failure to disclose has been rectified.

By fashioning such a flexible damage rule, the Court has interpreted section 28(a)[48] of the Securities Exchange Act of 1934 broadly

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[44]*See* Securities Exchange Act of 1934, § 2, 15 U.S.C. § 78b (1970).

[45]The fair value of what the seller would have received is a factual question left to the trial court. In the *Affiliated Ute* case, some of the factors involved in the trial court's assessment of the fair value were the substantial present value and great potential value of the corporate assets, the improper activities of the defendants, and the excess of sellers over buyers. 92 S. Ct. at 1473. The discretionary power in assessing damages can be a substantial deterrent to defendant misconduct. In *Affiliated Ute*, the stock was valued at $1500 per share despite the fact that this figure almost doubled the highest price at which the stock was traded as a result of the defendants' failure to disclose.

[46]This rule is applicable when the defendant's profit is the proximate consequence of the fraud. Such a formulation involves a constructive trust approach. 2 A. BROMBERG, *supra* note 18, § 9.1. The rule, if applied to "paper profits", would deter fraudulent conduct by assuring the fraudulent party of the futility of profiting by his fraudulent conduct.

[47]The fair value of the stock at the time of the sale, determined by the trial court to be $1500, far exceeded any profit realized by the defendants.

[48]Section 28(a) of the Exchange Act provides in part: "The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb(a) (1970). The House Committee on Interstate and Foreign

enough to include an equitable remedy and thereby to effectuate the deterrent value of the Act by requiring the wrongdoer to "disgorge his fraudulent enrichment";[49] yet, at the same time, the Court's interpretation of section 28(a) is not so broad as to subject defendants, as a group, to unwarranted liability.

Because of the liberalization of the elements of a 10b-5 cause of action,[50] the class of potential defendants from whom an injured plaintiff may recover is broader than the class of defendants from whom an injured plaintiff may recover in a common law action. Moreover, because of the extremely liberal jurisdiction and venue requirements of the Securities Exchange Act of 1934, the class of potential defendants in a 10b-5 action is more accessible than the class of potential defendants in a common law action. For these reasons, it seems appropriate that the Court limit the measure of damages in a 10b-5 cause of action. Such a limitation does not preclude a plaintiff from pursuing an action at law or in equity if the remedy he seeks is excluded in a 10b-5 action,[51] provided the plaintiff satisfies the more stringent elements of such a claim.

In *Affiliated Ute,* the Court has spoken in an area in need of clarification, and by its ruling has paved the way for uniform, equitable recovery in 10b-5 actions.

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Commerce cast little light on the proper interpretation of "actual damages" under section 28(a) when it limited comment on the section to the following: "This subsection reserves rights and remedies existing outside of those provided in this Act, but limits the total amount recoverable to the amount of actual damages." H.R. REP. No. 1383, 73d Cong., 2d Sess. 28 (1934); 2 A. BROMBERG, *supra* note 18, § 9.1.

The case law on the interpretation of section 28(a) is divided. *Compare* Myzel v. Fields, 386 F.2d 718, 748 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968) (permitting a plaintiff to recover defendant's profits) *and* Hecht v. Harris, Upham & Co., 283 F. Supp. 417 (N.D. Cal. 1968) (recognizing the suitability of punitive damages for a 10b-5 violation) *with* Kohler v. Kohler Co., 208 F. Supp. 808, 825 (E.D. Wis. 1962) (dictum), *aff'd,* 319 F.2d 634 (7th Cir. 1963) (restricting damages under section 28(a) to a computation under the federal "out-of-pocket" rule applied in fraud actions).

Professor Loss contends that section 28(a) "simply precludes a double recovery . . . under 10b-5 and in common law deceit." 3 L. LOSS, SECURITIES REGULATION 1474 n.105 (2d ed. 1961).

[49]Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965), *cert. denied,* 382 U.S. 879 (1965).

[50]*See* note 4 *supra.*

[51]*See* note 46 *supra.*